S. HRG. 101-163

NOMINATIONS OF JOHN B. TAYLOR AND JOHN MICHAEL FARREN

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

ON

THE NOMINATIONS OF

JOHN B. TAYLOR, OF CALIFORNIA, TO BE A MEMBER OF THE COUNCIL OF ECONOMIC ADVISERS, VICE MICHAEL MUSSA, RESIGNED

AND

JOHN MICHAEL FARREN, OF CONNECTICUT, TO BE UNDER SECRETARY OF COMMERCE FOR INTERNATIONAL TRADE, VICE W. ALLEN MOORE, RESIGNED

JUNE 8, 1989

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NOMINATIONS OF JOHN B. TAYLOR, OF CALIFORNIA, TO BE A MEMBER OF THE COUNCIL OF ECONOMIC ADVISERS, VICE MICHAEL MUSSA, RESIGNED; AND JOHN MICHAEL FARREN, OF CONNECTICUT, TO BE UNDER SECRETARY OF COMMERCE FOR INTERNATIONAL TRADE, VICE W. ALLEN MOORE, RESIGNED

THURSDAY, JUNE 8, 1989

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The committee met at 10 a.m. in room SD-538 of the Dirksen Senate Office Building, Senator Donald W. Riegle (chairman of the committee) presiding.

Present: Senators Riegle, Sarbanes, Dodd, Dixon, Shelby, Wirth, Garn, Heinz, D'Amato, Bond, Mack, Roth, Kassebaum, and Pressler.

OPENING STATEMENT OF CHAIRMAN RIEGLE

The CHAIRMAN. The committee will come to order.

This morning we have two nominees for important administrative posts. We have Dr. John Taylor for the Council of Economic Advisers and Mr. Michael Farren for Under Secretary of Commerce.

If we are able to build a quorum this morning—and I am hopeful that we will be able to do so—we will also mark up the nominations of Alfred Dellibovi for HUD Under Secretary and Susan Carol Schwab for Assistant Secretary of Commerce.

Professor Taylor, we welcome you. It is an important assignment that you have been nominated for. You have a very impressive academic record and experience in consulting various government agencies on macroeconomic policies.

Certainly your background is well-suited for the role of Council Member with responsibility for domestic and international macroeconomic analysis.

It is obvious that the current economic environment makes this a very important position. While we have benefited from a long economic expansion and unemployment rates are relatively low, there are many who are forecasting at least the possibility of a recession and even more are concerned about the possibility of rising inflation.

Our budget deficits, using honest accounting—and we don't do much of that around here—our budget deficits have stopped falling. This year's deficit is likely to be higher than the previous deficit for the second year in a row. Improvement in our trade deficit likewise appears to have bogged down.

Our net national savings are really very, very small and far below what is needed, and most of our net investment spending is offset by foreign investment. Americans will benefit less than we should from our economic growth in the future. Much of our gains are going to have to be sent abroad as earnings on investments by foreign interests.

So despite our current apparent economic health, there are a number of underlying problems—I am just touching on some of them here—that I think present us with some very serious challenges for the future, and so we are going to be interested in your views on those issues and others this morning.

You have with you our distinguished colleague, Senator Wilson, from California, who will make some introductory remarks in just a moment.

Let me inquire of my colleagues—Senator Bond, did you have a comment to make at this point?

Senator BOND. No comments, no.

The CHAIRMAN. Senator Sarbanes.

Senator SARBANES. Mr. Chairman, I will be very brief. I want to hear Mr. Taylor. I worked at the Council of Economic Advisers many years ago when Walter Heller was the Chairman, and so I am interested in the nominees to the Council and I am looking forward to hearing from Mr. Taylor.

The CHAIRMAN. Thank you, Senator Sarbanes.

Senator Wilson, we would be pleased to hear from you at this point.

OPENING STATEMENT OF SENATOR WILSON

Senator WILSON. Thank you very much, Mr. Chairman.

Mr. Chairman, your own brief, but eloquent opening remarks make it clear that you are familiar with the almost remarkable background of the nominee.

It is a great pleasure for me to appear before the committee to introduce John Taylor. He has an extraordinary background. He has won more honors than we have time to recite, and he has been a tenured and distinguished professor at a number of leading universities—Princeton, Columbia, and Stanford.

You have indicated that he is a specialist and an acknowledged leader in the field of macroeconomics and monetary policy.

With the selection of Dr. Taylor and Dick Schmalensee, President Bush will have assembled, I think, a very highly regarded Council of Economic Advisers under the chairmanship of Professor Mike Boskin, who has told me, by the way, that John Taylor was the nearly unanimous recommendation of a very wide spectrum of economic policymakers and professional economists.

He is presently a teacher or a professor at Stanford and has published over 70 papers and books. His textbook in macroeconomics is used at over 250 universities in the United States. In interviews

conducted this March by the New York Times, John Taylor received accolades from his colleagues, including Joe Pechman, the current president of the American Economic Association, and Robert Eisner, the outgoing president. He is widely and very, very highly regarded by his peers.

Before moving to Stanford, he taught economics at the Woodrow Wilson School of Public and International Affairs at Princeton.

His government service, as I believe you indicated, includes positions as Senior Staff Economist at the Council of Economic Advisers in the Ford administration, and more recently he has served as an adviser to the Federal Reserve Board.

He is, to put it briefly and simply, extraordinarily well-qualified for this position, and for that reason I have great pleasure in bringing him before you.

He was an undergraduate at Princeton. That seems to be one of the small defects in his background, and I say that to see whether or not Senators Bond and Sarbanes are awake and will respond to debate. [Laughter.]

The CHAIRMAN. Thank you very much, Senator Wilson.

Senator Mack, did you have an opening comment that you wanted to make?

Senator MACK. No, thank you, Mr. Chairman.

The CHAIRMAN. I will have to administer an oath to our nominee either before any opening comments that he may wish to make or as we start the question period. I think I would just as soon do it now. So let me ask you to stand and raise your right hand, if you would.

[Witness sworn.]

The CHAIRMAN. Thank you very much.

Dr. Taylor, we are pleased to have you here, and you come with very high recommendation from a number of distinguished people, including our colleague who sits to your right.

So we would be pleased to hear your initial comments now.

TESTIMONY OF JOHN B. TAYLOR, OF CALIFORNIA, TO BE A MEMBER OF THE COUNCIL OF ECONOMIC ADVISERS, VICE MICHAEL MUSSA, RESIGNED

Mr. TAYLOR. Thank you, Senator, and thank you very much, Senator Wilson, for those kind remarks.

The CHAIRMAN. Let me just indicate that I don't know whether Senator Wilson needs to be elsewhere. If he does, I want him to feel free to stay and join us or leave as he may need to.

Senator WILSON. Thank you very much, Mr. Chairman.

Senator SHELBY. Mr. Chairman, excuse me.

The CHAIRMAN. Yes. Senator Shelby.

Senator SHELBY. I just want to say he probably needs to be back in California running for Governor.

The CHAIRMAN. Well, in that case I think we will ask Senator Wilson to stay.

Senator WILSON. I don't think that is what the chairman had in mind. [Laughter.]

The CHAIRMAN. We will need him here this morning now that I think about it.

Senator WILSON. Mr. Chairman, I appreciate your courtesy, and I will stay for as long as I can. I would like to hear his statement. Then I do have to move on.

Senator SARBANES. He just lost all the Princetonian vote in California, of which there are a number.

Senator BOND. That is probably at least 10 or 15, but I would say that our colleague's opening statement did remind me of the 8 o'clock religion lecture in which many people slept through and I am glad you did mention Princeton, Senator Wilson. [Laughter.]

The CHAIRMAN. Senator Shelby, while we have had the interruption, did you have any opening comment that you wanted to make?

Senator SHELBY. Mr. Chairman, I don't have an opening comment.

The CHAIRMAN. Without objection, it will be. I also have statements from the Senators Dixon, Sasser, Sanford, and D'Amato.

JUNE 8, 1989

STATEMENT OF SENATOR ALAN DIXON

SENATE BANKING COMMITTEE HEARING
ON THE NOMINATIONS OF
JOHN B. TAYLOR TO BE A MEMBER
OF THE COUNCIL OF ECONOMIC ADVISORS
AND
JOHN M. FARREN TO BE UNDER SECRETARY
OF COMMERCE FOR INTERNATIONAL TRADE

MR. CHAIRMAN, I AM PLEASED TO BE HERE THIS MORNING AS THE SENATE BANKING COMMITTEE CONDUCTS ITS HEARING ON THE NOMINATION OF JOHN B. TAYLOR TO BE A MEMBER OF THE COUNCIL OF ECONOMIC ADVISORS AND JOHN M. FARREN TO BE UNDER SECRETARY OF COMMERCE FOR INTERNATIONAL TRADE.

I THINK IT IS PARTICULARLY APPROPRIATE TO BE CONSIDERING THESE TWO NOMINATIONS TOGETHER BECAUSE OUR TRADE SITUATION AND OUR TRADE POLICIES ARE DIRECTLY RELATED TO OUR OVERALL ECONOMIC PERFORMANCE. OUR PERSISTENT BUDGET DEFICITS ARE A MAJOR CAUSE OF OUR TRADE AND BALANCE OF PAYMENTS PROBLEMS.

WE NEED TO OVERHAUL OUR BUDGET POLICIES. I CANNOT THINK OF ANYTHING MORE IMPORTANT TO OUR TRADE SITUATION AND MAINTAINING ECONOMIC GROWTH IN THE FUTURE. AT THE SAME TIME, WE NEED TO RECOGNIZE THAT OUR TRADE POSTURE BE REVISED TO REFLECT THE CHANGED REALITY AND INCREASED WORLDWIDE COMPETITION WE ARE FACING.

THE BANKING COMMITTEE HAS IMPORTANT POLICY ROLES TO PLAY IN BOTH OF THESE CRUCIAL AREAS. WE HAVE JURISDICTION OVER THE THIRD WORLD DEBT ISSUE, WHICH HAS IMPORTANT MACROECONOMIC IMPLICATIONS. WE HAVE JURISDICTION OVER EXPORT CONTROLS, EXPORT FINANCE, AND INTERNATIONAL FINANCIAL AND EXCHANGE RATE POLICY. WE WILL SOON GO TO CONFERENCE WITH THE HOUSE ON THE THRIFT BILL, A BILL WITH A MAJOR IMPACT ON THE FEDERAL BUDGET. WE HAVE JURISDICTION OVER HOUSING POLICY, ONE OF THE PILLARS OF OUR ECONOMY. I AM VERY INTERESTED IN HEARING THE VIEWS OF THE TWO NOMINEES ON THESE BANKING COMMITTEE ISSUES AND ON OTHER VITAL ISSUES THAT FALL WITHIN THEIR PURVIEWS.

STATEMENT OF SENATOR JIM SASSER BEFORE THE SENATE HOUSING SUBCOMMITEE ON THE HEARING ON THE HOP AND HOME PROGRAMS, JUNE 7, 1989

MR. CHAIRMAN, WE WILL HEAR DISCUSSION TODAY ON TWO OF THE MOST IMPORTANT COMPONENTS OF THE NATIONAL AFFORDABLE HOUSING ACT: THE HOUSING OPPORTUNITY PARTNERSHIP PROGRAM (HOP) AND THE HOME CORPORATION. THESE PROGRAMS PROMISE TO ENCOURAGE PRIVATE AND PUBLIC SECTOR COOPERATION IN THE CREATION OF NEW LOW-INCOME HOUSING PROJECTS.

THROUGHOUT MY SERVICE IN THE SENATE, ONE PRINCIPLE HAS BECOME APPARENT: THE FEDERAL GOVERNMENT FUNCTIONS MOST EFFICIENTLY WHEN IT WORKS WITH STATE AND LOCAL GOVERNMENTS AND CAN BENEFIT FROM THEIR SPECIALIZED KNOWLEDGE. THE HOP AND HOME PROGRAMS EMBRACE THE CONCEPT OF COOPERATION THAT IS ESSENTIAL TO THE SUCCESS OF ANY HOUSING PROGRAM. THEY MAKE HUD ACCESSIBLE EVEN TO THOSE STATE AND LOCAL GOVERNMENTS WITH LITTLE EXPERIENCE IN HOUSING PROGRAMS.

I LOOK FORWARD TO HEARING THE OPINIONS OF OUR EXPERT WITNESSES ON THE HOP AND HOME PROGRAMS.

Terry Sanford

OPENING STATEMENT OF SENATOR TERRY SANFORD

JUNE 8, 1989

HEARING ON THE NOMINATION OF JOHN B. TAYLOR, TO BE A MEMBER OF THE COUNCIL OF ECONOMIC ADVISORS AND J. MICHAEL FARREN, TO BE UNDER SECRETARY OF COMMERCE

GOOD MORNING, CHAIRMAN REIGLE, DISTINGUISHED MEMBERS OF THE COMMITTEE, LADIES AND GENTLEMEN.

I AM PLEASED TODAY TO MEET WITH THE COMMITTEE TO HEAR THE TESTIMONY OF JOHN. B. TAYLOR, NOMINATED TO BE A MEMBER OF THE COUNCIL OF ECONOMIC ADVISORS, AND J. MICHAEL FARREN, NOMINATED TO BE UNDER SECRETARY OF COMMERCE FOR INTERNATIONAL TRADE. I COMMEND THE ADMINISTRATION FOR THEIR RECOMMENDATIONS OF THESE TWO INDIVIDUALS. JUDGING BY THEIR RESUMES AND EDUCATIONAL BACKGROUND IT SEEMS THEY ARE BOTH APTLY QUALIFIED FOR THE POSITIONS FOR WHICH THEY HAVE BEEN RECOMMENDED. IN THE POSITIONS THEY HAVE BEEN ASKED TO FILL EACH COULD HAVE A SIGNIFICANT ROLE IN SHAPING U.S. ECONOMIC POLICY.

THE COUNCIL OF ECONOMIC ADVISORS PLAYS A VERY IMPORTANT ROLE IN THE DEVELOPMENT OF HONEST ECONOMIC ASSUMPTIONS. CONGRESS TRUSTS THAT THE NUMBERS THEY RECEIVE FROM CEA ARE FREE FROM BIAS AND TRUE REFLECTIONS OF THE NATION'S

ECONOMY. I TRUST THAT MR. TAYLOR UNDERSTANDS THE IMPORTANCE OF THE CEA AND ITS ROLE IN THE DEVELOPMENT OF U.S. ECONOMIC POLICY.

AT A TIME OF THE HIGHEST TRADE DEFICIT IN THE HISTORY OF THIS COUNTRY, IT IS IMPERATIVE THAT WE HAVE STRONG LEADERSHIP IN THE DEPARTMENT OF COMMERCE'S INTERNATIONAL TRADE ADMINISTRATION. AMERICAN FIRMS NEED TO KNOW THAT OUR LAWS REGARDING UNFAIR TRADE WILL BE EFFECTIVELY AND EFFICIENTLY ADMINISTERED. WE NEED TO AGGRESSIVELY USE THE U.S. AND FOREIGN COMMERCIAL SERVICE TO PROMOTE THE SALE OF U.S. PRODUCTS ABROAD. I AM VERY INTERESTED IN HEARING HOW MR. FARREN WILL ENSURE THE PROMOTION OF U.S. PRODUCTS IN INTERNATIONAL TRADE.

AS I UNDERSTAND MR. CHAIRMAN, WE WILL ALSO BE VOTING TODAY ON THE NOMINATIONS OF ALFRED DELLIBOVI TO BE UNDERSECRETARY OF HUD AND SUSAN CAROL SCHWAB TO BE ASSISTANT SECRETARY OF COMMERCE AND DIRECTOR GENERAL OF THE UNITED STATES AND FOREIGN COMMERCIAL SERVICE. I SUPPORT THE ADMINISTRATION'S RECOMMENDATIONS OF THESE TWO CANDIDATES AND I AM HOPEFUL THAT THE ADMINISTRATION CONTINUES IN THIS VEIN TO PROVIDE US WITH SUCH CAPABLE AND QUALIFIED INDIVIDUALS.

STATEMENT OF SENATOR D'AMATO

MR. CHAIRMAN, I AM PLEASED TO WELCOME PROFESSOR TAYLOR TO THE BANKING COMMITTEE. I AM ALSO PLEASED TO NOTE HIS FINE CREDENTIALS FOR THE POST TO WHICH HE IS NOMINATED. CERTAINLY MR. TAYLOR'S CAREER AND WRITINGS IN THE FIELD OF ECONOMICS INDICATE A SERIOUS PROFESSIONAL DEDICATION TO THAT FIELD.

I ALSO TAKE PLEASURE IN NOTING THAT, DESPITE HIS MORE RECENT POSTS AT PRINCETON AND STANFORD UNIVERSITIES, THAT PROFESSOR TAYLOR IS A NATIVE OF YONKERS, NEW YORK AND BEGAN HIS TEACHING CAREER AT COLUMBIA UNIVERSITY IN NEW YORK CITY. THEREFORE, HE IS, BY BIRTH AND EARLY TRAINING ACCUSTOMED TO COMPLEX PROBLEMS AND AN INTELLECTUAL ENVIRONMENT SUCH AS HE WILL ENCOUNTER HERE IN THE GOVERNMENT.

I WOULD LIKE TO SUGGEST TO THE NOMINEE THAT UPON HIS CONFIRMATION THAT HE CONSIDER THE ISSUE OF THE INCREASING FOREIGN OWNERSHIP OF U.S. ECONOMIC ASSETS. THIS IS A TREND THAT INCREASED DRAMATICALLY BETWEEN 1987 AND 1988 AND, NO DOUBT, CONTINUES ON THE UPSWING.

THIS IS NOT AN ALTOGETHER BAD THING SINCE IT BRINGS CAPITAL TO THE U.S. I DO NOT INTEND TO CRITICIZE THOSE WHO INVEST HERE OR TO ARGUE WITH THOSE WHO SAY THAT FOREIGN INVESTMENT IS A SIGN OF CONFIDENCE IN THE AMERICAN ECONOMY. HOWEVER, AS YOU KNOW, MR. CHAIRMAN, THE MOVEMENT OF THE FRUITS OF AMERICAN LABOR TO OFFSHORE INVESTORS IS A TREND

THAT WILL IN THE LONG RUN LEAD TO A DECLINE IN OUR STANDARD OF LIVING.

I AM THEREFORE CONCERNED WITH THE TREND OF FOREIGN OWNERSHIP OF THE OUR PRODUCTIVE ASSETS. IT SEEMS TO ME THAT OUR LOW DOMESTIC SAVINGS RATE IS ONE CAUSE OF THIS TREND. IF MORE CAPITAL WAS AVAILABLE IN THE U.S. CAPITAL MARKETS FOR INVESTMENT, AMERICAN INVESTORS WOULD BE BUYING OUR PRODUCTIVE ASSETS INSTEAD OF THE BRITISH, THE JAPANESE AND THE CANADIANS.

I REALIZE THAT TO AN ECONOMIST THESE ISSUES RAISE COMPLEX ADDITIONAL ISSUES. HOWEVER, IT SEEMS TO ME THAT OTHER GOVERNMENTS ARE PROVIDING INCENTIVES TO SAVINGS AND INVESTMENT AND THIS GOVERNMENT HAS CREATED DISINCENTIVES WHICH OTHER COUNTRIES' CITIZENS DO NOT FACE THAT PROMOTE FOREIGN OWNERSHIP AND THE FLOW OF PROFITS OVERSEAS. THIS IS A MATTER THAT BEARS SOME ADDITIONAL STUDY AND I WOULD APPRECIATE YOUR LOOKING INTO THIS RELATIONSHIP AS YOU ASSUME YOUR DUTIES WITH THE COUNCIL OF ECONOMIC ADVISERS.

The CHAIRMAN. Dr. Taylor.

Mr. TAYLOR. Mr. Chairman and distinguished members of this committee, it is a great honor for me to appear before you today as a nominee to be a Council Member of the President's Council of Economic Advisers.

Many distinguished economists for whom I have great admiration have preceded me in this job, including Nobel Laureate James Tobin, the late Otto Ecstein, Herbert Stein, and Burton Malkeo, who was my former teacher and colleague at Princeton and who was a Council Member when I was on the Senior Staff at the Council in the Ford Administration. It would be a great honor for me to join with these distinguished economists.

Prior to being nominated as a Council Member, I have served as a professor of economics at Stanford University, where I have lived for the past 5 years with my wife and two children. Although I am now from California, I was born in New York, raised in Pittsburgh, and spent the first 10 years of my academic career in the east at Princeton University and Columbia University.

My academic career has been devoted to teaching, research, and writing. However, over the years I have maintained close relationships with the Government and business community.

In addition to my former position at the Council of Economic Advisers, I have been an adviser to the Federal Reserve and the Congressional Budget Office and a consultant to Alan Greenspan's former firm in New York.

I have worked in Tokyo, the Bank of Japan, and in Helsinki at the Bank of Finland.

It is with this experience that I come before your committee to seek confirmation today.

My work at the Council will focus on macroeconomics, fiscal and monetary policy, and international economics. These are my areas of expertise as an economist. My teaching, research, and consulting work have been primarily in these areas.

I will make every effort I can to give advice based on sound, objective, and comprehensive economic analysis. I will always be available to discuss economic issues and receive input from the Congress.

In conclusion, I would like to thank you very much for considering my nomination, and I would be happy to answer any questions you and any members of the committee may have.

The CHAIRMAN. Thank you for your opening comment, and I want to also draw attention to the fact that you have indicated that you are going to put your assets in a qualified blind trust and that your wife is doing likewise. Just speaking as one member of the committee, I appreciate your sensitivity to that issue and the fact that you are making that move. That is not always an easy thing to do coming into Government service, but I know the administration is trying to elevate the standards so that there can be no question about conflicts of interest.

Mr. TAYLOR. Thank you, Senator. I might add to that, we will make every effort to avoid any kinds of conflicts of interest, whether it requires selling, divestiture, or setting up a trust of this kind.

The CHAIRMAN. Now, I want to in the time that we have this morning with my colleagues present—and Senator Kassebaum is

just joining us—say again how much this committee feels the work of the Council of Economic Advisers takes on a greater importance in the circumstances in which we find ourselves than perhaps that Council has had or needed to have in times past. I think we are clearly in a period of epic, global economic change, of a kind that is without parallel in at least the last 50 years. There is probably nothing comparable to it in any meaningful sense in our long history.

The changes in global markets, the development of those markets, our debtor nation status, the fact that we are adding international debt as a nation at the rate of about a billion dollars every 3 days I find very troubling trendlines to be riding down into that international debtor's hole.

I know that some say, well, don't worry too much about that because, in conjunction with the trade deficit we are getting the video recorders and Toyota cars and whatever else it is that we are buying and some of the money is coming back in the form of direct investment, not a great deal but some is coming back. Certainly buying debt instruments is a part of it, but also fixed investment in plants and things of that kind.

It seems to me the problem with that as a long-term strategy is that to the extent that you necessarily have to do that to balance the international trading accounts, the more foreign ownership that occurs here. I don't have any xenophobia in what I am saying here, but the question of who derives the earnings from future success of investments in the United States is a real question. Just as we benefit by being investment owners of assets abroad and, to the extent we can, rebate earnings from those assets to the United States, obviously other nations investing here plan to do exactly the same thing.

There are all kinds of other competitive wrinkles that add to that concern, such as foreign investors come in and try to pick off promising technologies and things of that kind.

I would like your bluntest and most plain language view of the nature of our trade deficit hanging in there at somewhere between $120 and $140 billion. How serious is it if it stays at that level or were to go higher, and what does it mean? Where do you put it on your spectrum of issues that concern you about, you know, the economic future of this country 5 years out, 10 years out?

Mr. TAYLOR. Thank you, Senator.

The concern to me from the trade deficit is most related to what I consider the underlying cause of the trade deficit, and that is a savings and investment imbalance in the United States. We are saving too little, and as a result of that, we are importing capital from abroad. Our foreign trade deficit reflects that import of foreign capital, and as long as we have that savings and investment imbalance we will continue to have that trade deficit.

One of the most effective ways to take a stab at that trade deficit is to raise national savings, and the most important policy instrument we have for that at this point is a continued effort to reduce the Federal budget deficit.

The trade deficit has improved, not as far as we would like, but it took a long time getting there. It took a long time getting to the bad levels that it was 1½ years ago. But it has improved. Since the

first quarter we have seen more improvement, and I am optimistic for continued improvement, assuming that we are successful in reducing the Federal budget deficit.

The CHAIRMAN. Even if the dollar stays as high as it is? We have had a big run-up in the value of the dollar. Does that not threaten what progress we have made in bringing the trade deficit down?

Mr. TAYLOR. It certainly goes in the direction of reducing the growth in net exports, and therefore slowing the improvement in the trade deficit. However, the run-up in the dollar has to be compared to the huge fall in the dollar in the previous 2 years, from which we are still benefiting, and I think the lag effect of that improvement in the dollar will continue to have effects despite at a slower rate as a result of the dollar increase recently.

The CHAIRMAN. I hope you are right. My own view is that we have stalled out in trade improvement. I think we are going to have a very tough time getting it below $120 billion a year, and I think it is likely to begin to edge back up with some of the currency problems we have. Hopefully, the Super 301 procedure will start to help us to some extent.

Just one other related question. The New York Federal Reserve Board is estimating that by roughly 1992 our net debtor nation position is going to take us up to a level of $1 trillion.

What does it mean or what do you think it means for the United States if we stay on this kind of trendline? What are the implications? Is it something we ought to be concerned about or is it something we can take in stride and just don't worry, be happy, and everything will work out fine?

Mr. TAYLOR. Sir, I think it is important to be concerned about that problem. What that means is that future generations of Americans sooner than that, in the next 10 years, will be paying to foreigners a substantial amount of return from the investment in the United States, and that will require us to generate a surplus just to pay that amount off.

So I think it is a concern, but basically what it means is that if we don't raise our savings rate we will have a lower standard of living in the future. It is a question of consuming now versus consuming tomorrow, and the more we consume today, the more foreigners will invest in this country, and the less we will consume later and instead be paying foreigners what we could be consuming ourselves in the future.

The CHAIRMAN. Now, if we get the Federal budget deficit down, that would be a way of increasing national saving because we would stop dissaving to the extent that we are currently.

What strategy, ideas are you likely to advocate and propose in terms of how we jack up the personal savings rate?

Mr. TAYLOR. There's a number of tax incentive proposals which have been discussed over the years, some of which I think could have effect. At this point the administration has not proposed any of these. Many of them have budgetary impacts, which need to be taken into account in the short run.

The CHAIRMAN. Let me just stop you. You are not in the administration yet, though you are about to be. I am really asking you for your professional, private opinion. You are a serious economist. You may have a point of view in there that may or may not pre-

vail, but you are still in essence your own man today, and I am wondering what you think are the best strategies to jack up the personal savings rate.

Mr. TAYLOR. I have always thought that Individual Retirement Accounts have an effect on saving. There is some statistical evidence to suggest that. It is controversial. There's people on both sides of the issue. I can see both sides, but as I read the numbers, there is evidence that Individual Retirement Accounts do stimulate saving, and that would be one possibility to consider in the future to stimulate saving. That is an important example.

The CHAIRMAN. Let me—I hope you will have other thoughts on that, and I would like to hear them, not in this setting because of the time pressures—but let me ask you one other thing.

In your textbook on macroeconomics you describe quite clearly how the 1981 tax cut, in your words—and I am taking this obviously out of the context in which you presented it in your book—"brought about a gigantic budget deficit and that in turn led to our trade deficit." You sort of touched on those relationships here already this morning.

If that is right, was the rise of that big budget deficit, structural deficit if you will, the result of the fact that the tax cut, as you would see it, had the wrong policy mix to it and we didn't really get the cornucopia of additional revenue that some thought we might, or would it be your view that the tax cut structure and mechanics was about right but it just wasn't geared to produce a sufficient amount of revenue, so therefore maybe you needed the same mix but with a different rate structure so that that mix could produce just a larger volume of revenue? How do you see that?

Mr. TAYLOR. My interpretation of the tax cuts in the early 1980s was that they effectively reduced the rate of increase in taxation relative to the growth of nominal GNP or relative to the growth of the economy. They enabled us to keep taxes as a ratio to GNP roughly stable.

As a result of continued growth in Government expenditures, the deficit grew, and in addition, the deep recession we had in 1981 and 1982 caused a cyclical increase in the deficit, which of course was a large part of the deficit increase at that time. But the structural deficit which we are still left with is not resulting in a bad calculation of the effect of the tax cuts in 1981–82, but of a basic mismatch between spending and taxes generally, and it is not possible to pinpoint taxes——

The CHAIRMAN Yes, but let me just take that one step further, and my time is up here, but in the past 8 years, the Congress, the Executive, one branch for most of the time has been in the control of one party, one in the other. But we don't make any spending decisions that everybody doesn't sign off on together. So if there was a collective decision by the administration at that time and the Congress that the spending level had to be at such and such a point that was found to be the minimum amount of spending that we required in order to run the Government, if you had a collective decision to that extent and we found we couldn't cut spending any more, would it be your view then that you just take the deficit that results from whatever the shortfall is between that compressed spending level and the reduced revenue? If that gives you big

deficits, do you just sort of say, well, that is a heck of a note and just keep going?

Mr. TAYLOR. I think it is very important to reduce the budget deficit to zero along the lines of the current Gramm-Rudman-Hollings paths.

The question about whether spending is too high or too low is actually part of the current negotiations at this time, and I think it is best to let those budget negotiations continue, with the aim at meeting the Gramm-Rudman targets. That is my view of the problem—not to let the deficit get large and be negligent about that.

The CHAIRMAN. Right. You would not dispute the fact that our national outstanding debt has gone from roughly $1 trillion in 1981 to roughly $2.5 trillion?

Mr. TAYLOR. No, Senator, I wouldn't. I wouldn't dispute those numbers. As a rough, round magnitude, definitely.

The CHAIRMAN. Well, with all due respect, I think we have got to have a practical answer to that problem. I mean, we have had all the theory and Laffer curves and backs of envelopes and everything else, and we have got a deluge of red ink that you acknowledge has created these huge and threatening financial trendlines and problems that may be out ahead of us if we don't change it, and I think you carry the burden, as do we, to come up with practical answers.

As we sit here today, we haven't done much. I mean, I don't know if you have got an accounting background, but we use phony accounting in the Federal Government, and I assume as a professional economist you look behind the numbers, and if you are really hanging your hat on the Gramm-Rudman calculations, using the Social Security surpluses and everything else to doctor the numbers, you are kidding yourself. You wouldn't let your students get away with that on a term paper, and I hope you won't fool yourself or be part of an effort to fool the country on that.

Mr. TAYLOR. No, sir.

The CHAIRMAN. Senator Kassebaum, you have come in. I wondered if you had an opening comment that you wanted to make.

Senator KASSEBAUM. Thank you, Mr. Chairman.

I wandered here, to tell you the truth, because I was told you needed a quorum, and I am really quite fascinated with this discussion, and so I am glad I came.

But, thanks. I will wait my turn.

The CHAIRMAN. The chairman is very grateful for those members that come when we need to establish a quorum, and we will in due course report out some nominees this morning.

Senator Bond.

Senator BOND. Thank you, Mr. Chairman.

Dr. Taylor, to look at the converse of the questions that you were asked, obviously the level of taxes was jointly agreed on as well, as well as the level of spending.

Was it your position that in 1981 from an economic standpoint it did not make sense to lower taxes, or did you feel that we should have lowered taxes and lowered spending, or based on your analysis should have done neither?

Mr. TAYLOR. My position at the time was that we should have lowered tax rates. One of the primary reasons for that, in my view,

was to offset the growth in taxes relative to income or GNP and to keep sort of the tax revenues constant as a share of GNP, and I think it had that effect.

If it was not matched with the same kind of action on the spending side, it would cause a deficit, as it seems to have, and that of course is a bad thing for the U.S. economy to have this deficit, and I will work as hard as I can to keep the deficit from growing and to meet these targets.

Senator BOND. There is no question, reviewing your biography and the high recommendations with which you come, that you are widely regarded as an outstanding economics/macroeconomics scholar. One of your great challenges will be to explain these principles to those of us who may not have paid sufficient attention in our economics classes in college.

Would you give me a 40- or 60-second explanation—I notice you have a forthcoming article, "Monetary Policy and the Stability of Macroeconomic Relationships." Would you tell us in under a minute what is of importance in that article that we should know?

Mr. TAYLOR. Yes, sir. The article refers to the different degree of economic stability in the United States compared to Japan. In the last 15 years, the U.S. economy has had larger business cycle fluctuations, from the peak to the trough in the business cycle, than has the Japanese economy.

That paper tried to explain the phenomenon. It tried to look for answers to why that occurred. The Japanese economy has grown very smoothly compared to the U.S. economy and, I might add, compared to many European economies.

Senator BOND. And your conclusion was?

Mr. TAYLOR. The question was, was that due to monetary policy and more efficient monetary policy? Was it due to a different type of wage structure, wage bargaining structure amongst unions?

In Japan there is a system called the Shunto, which translates as the spring offensive, in which most workers have their wages adjusted in the same quarter of the year, and many economists have argued that that leads to more flexibility in the economy.

Another explanation is larger profit sharing type arrangements, and more important ones like that in Japan makes wages more flexible and increases the flexibility of the economy.

So it is labor markets or monetary policy, and my analysis suggested that the differences in labor market institutions were part of the reason for the greater economic stability, but I gave the Bank of Japan some credit for good monetary policy as well.

Senator BOND. And that is the difference between the United States and Japan, labor market flexibility and the monetary policy?

Mr. TAYLOR. That will explain some of the difference, not all of it, Senator. But that will explain some of it.

Senator BOND. The question has been raised whether we have stalled out in exports. If we have time, I might ask you to explain in very simple terms the concept that the trade deficit necessarily results from the gap between the net national savings and the demand for capital, from the budget deficit and the need for capital investment.

But let me ask you, do you feel that we necessarily are stalled out on exports and what can we do—if it is not inevitable, what can we do to get out of it?

Mr. TAYLOR. I don't think we are necessarily stalled out on exports. I believe the former decline in the dollar still has some impact left into it and it will not deteriorate in the near future. The growth will slow down, of course. That would be the most objective thing one could say because of the recent rise in the dollar. That will not have a large effect, in my view, but will have the effect of reducing the growth somewhat.

What we can do about it, in my view, is work on the savings investment imbalance. I truly think that that imbalance is at the heart of the trade deficit, and it is a matter of our not saving as much as we are investing. The United States is a good place to invest. Investment rates are high by many measures. The ratio of real investment to real GNP is as high as it has been in the postwar period. This is an attractive place to invest, and Americans are not investing as much to cover that.

Senator BOND. Do you think we need to do any more on the nuts and bolts of promoting exports?

Mr. TAYLOR. I think the most important thing is for us to make sure that foreign markets are open to U.S. products and to work to promote free and fair trade, and that is the most effective thing we can do for U.S. exports.

Senator BOND. Well, I happen to think that we haven't done enough to promote exports. It so happens this afternoon I am going to be introducing an export promotion bill that deals with the nuts and bolts of export development because I think we have put too much time on trying to open up markets when closed markets are only 15 to 20 percent of our problems. We are not doing the job that other countries are.

I would be happy to submit to you a copy of the bill, and maybe you can either tell me what is wrong with it or offer some support.

I thank you for coming.

Mr. TAYLOR. Thank you, Senator. I promise to look at it very carefully, and I sympathize with your viewpoints very much.

The CHAIRMAN. Senator Sarbanes has of course been one of the most important members of the Joint Economic Committee of the House and Senate for some time and has a great interest in these issues.

Let me yield to Senator Sarbanes.

Senator SARBANES. Thank you very much, Mr. Chairman.

Mr. Taylor, I am always curious as to how appointments come about.

How did your appointment come about?

Mr. TAYLOR. Well, I was asked officially by the President in a telephone call. Before that, of course, I had some information that the job would be available and I indicated my interest.

In fact, there is a funny story. The President called when I had pretty much decided and had planned a trip to Washington to talk to people, and in the conversation the President says when are you going to be here, and I said tomorrow, since my plane was scheduled. So it was a pretty impressive way to start off my job.

But it came about through exploring whether I would be interested and my thinking about it very seriously and consulting my family, deciding whether it was a proper thing to do, and I decided I would be very enthused to do it, to participate in policymaking.

I have been studying policy for years. The opportunity to participate and do some good was very attractive to me.

Senator SARBANES. Now, I take it you were contacted about whether you were interested in serving on the Council, is that right?

Mr. TAYLOR. Yes, sir.

Senator SARBANES. Or was it instigated by you?

Mr. TAYLOR. No, sir.

Senator SARBANES. And was it Michael Boskin who got in touch with you about that initially?

Mr. TAYLOR. Yes, sir.

Senator SARBANES. For how long does Stanford give one of its tenured faculty leave in order to undertake a position of this sort?

Mr. TAYLOR. The rule is 2 years. The time in which that would begin is when I would begin the job, when and if confirmed. There are exceptions. There are exceptions that have been made to that rule. One of the most notable exceptions I know about is George Schultz.

Senator SARBANES. George Schultz, right.

Mr. TAYLOR. I am obviously a different category, but there is a possibility for changing that.

Senator SARBANES. So in other words, it is not a firm rule that in 2—well, let me put the question this way In 2 years would you be facing the choice either of losing your tenured position if you wished to stay on or if the administration wished you to stay on or having to go back?

Mr. TAYLOR. In principle, Senator, yes. I might be asked to make a decision to resign completely my tenure at Stanford or to continue in the Government, but as I say, that is the rule and for reasons in the past it has been waived or reconsidered, and I just can't anticipate what would happen in my case at this time.

Senator SARBANES. Did you have an opportunity to read the transcript of Michael Boskin's confirmation hearing in the course of preparing for yours?

Mr. TAYLOR. Yes, sir. I looked through as much as I could.

Senator SARBANES. In that hearing the issue of the Federal Government's statistical infrastructure came up. I don't know if you recall that, whether you covered that part of the transcript.

Chairman Boskin has indicated a very strong commitment to trying to upgrade the Federal Government's statistical infrastructure, and I wondered whether you have any thoughts on that issue.

Mr. TAYLOR. I think it is a very important initiative for the Council of Economic Advisers to take to improve the quality of Federal statistics and to, if necessary, redirect priorities to areas where the statistics could be of more use for policymakers and for the private sector, and our first approach there is to set priorities and to see where improvements could be made. I think it is one of the most important things we are working on at this time.

Senator SARBANES. Well, Boskin is chairing the interagency group on that issue.

Mr. TAYLOR. Yes, sir.

Senator SARBANES. I would simply say this. I think setting of priorities is important, but I also think you are going to need some resources. I know the administration is extremely reluctant to consider anything that requires additional resources, but I would only point out that in the statistical area the amounts are very small in terms of the benefits. I mean, some of the agencies you are talking about, you know, what the Pentagon sort of dismisses with not even the back of their hand, and it could make a significant difference in the functioning of some of these agencies, and I hope you and Boskin will weigh in very hard on that matter.

I was interested in some of your responses earlier. Why is keeping tax revenues constant as a percent of GNP a fixed reference point in your economic thinking?

It seemed to be this morning. I am kind of curious as to why.

Mr. TAYLOR. It is really a rule of thumb that I was approaching the analysis of what should be happening. I noticed the trend of an increase in taxes relative to GNP, and that is a change in the status quo, and if our country decides that that change in the status quo is appropriate, then that is one thing. But it seems to me unless there is a specific mandate to change the existing situation, that that should be the situation we should take as the baseline or as the status quo.

That is the reason for the reference point.

Senator SARBANES. What about changing it in the other direction?

Mr. TAYLOR. The reason for it being the reference point is that that is really where it was at a particular point in time and changes in that it seems to me would require analysis of why a change is necessary. That is the reason for that reference point.

Senator SARBANES. For the past year the Federal Reserve has been trying to slow the economy, while the Bush administration was advocating stronger growth than the Fed seemed to desire.

What was your position on that dispute?

Mr. TAYLOR. I am not a part of the administration at this time, Senator. Let me say that I am optimistic about the U.S. economy's growth at this point. The falling interest rates which we have seen have been very positive in terms of my view about the future of the next couple of years in the economy. So I think the drop in interest rates which we have seen in the market in the last 2 or 3 weeks, the drop in the Treasury bill rate down to 8.1 percent, long-term bond rates down as much as 8.4 percent is an important positive implication—has an important positive implication for growth in the short term in the economy.

Senator SARBANES. At one point in time the Reagan administration was considering trying to do away with the Council of Economic Advisers altogether.

Mr. TAYLOR. I understand that, Senator.

Senator SARBANES. There was a period when they left the offices unfilled, and so forth and so on.

What is your own view of the importance of having a Council of Economic Advisers and its role in policymaking?

Mr. TAYLOR. I think the Council of Economic Advisers has played an important role in the past, and I hope very much it will contin-

ue to play an important role in the future. It is in many respects an important institution, and I have followed it for as long as I have been studying economics.

I think its role in the 1960's and in the 1970's was extraordinarily important, and I think the Council of Economic Advisers is an institution which I will work hard to uphold its role in the Federal Government and to serve as—to meet the responsibilities as indicated in the Employment Act of 1946, as amended in 1978. I think it is a very important agency in the Government, and I have seen it have positive effects over the years from the time it was founded in 1946.

I might add just as a personal note, I will be the first—if confirmed, I will be the first Council Member born after the Council of Economic Advisers was founded in 1946, and I think that shows to some extent its durability and the extent to which I think it will continue into future generations. It is very important.

Senator SARBANES. Well, that is an important passing down through the generations.

Mr. Chairman, I see my time is up. Let me simply make this closing comment.

I share your view that the Council plays—has played an important role and should play an important role. You bring a very distinguished record to the Council. I have a high respect for competence, and I think you bring high competence to the Council.

We may differ from time to time on policy, since I differ with the administration from time to time and you are going to be a member of the administration, but I think your nomination is a very important one coming along with Michael Boskin's, or following along Michael Boskin's, in restoring to the Council a degree of quality and competence that on occasion has been missing, and so I very strongly welcome this appointment. I commend the President for making it. I think you are going to bring significant strength to the Council.

I think there is a real challenge there for you, and I wish you well.

Mr. TAYLOR. Thank you very much, Senator.

The CHAIRMAN. I want to associate myself with the remarks of Senator Sarbanes with respect to the importance of the Council in reinvigorating and strengthening and elevating its stature and its analytical force within the economic policymaking area.

I might also say, while we have heard much today about west coast economics and east coast economics, the State of Michigan, which I represent, has had a long and important involvement with the Council of Economic Advisers as well on both sides with men like Gardiner Ackley and Paul McCracken and others.

So we take very seriously in our part of the country the question of how the economy is structured, how it is going and how we have to make needed adjustments to it.

Senator Mack.

Senator MACK. Thank you, Mr. Chairman. Welcome, Mr. Taylor.

Mr. TAYLOR. Thank you.

Senator MACK. The issue of the role of the tax cuts in 1981 has been kind of kicked back and forth here, and I would like to follow up a little bit on those discussions.

The way the chairman raised the issue, as I was listening, would make me conclude that what you said was that the tax cuts in 1981 created the deficit, and I would like to have some more clarification from you as to what your feelings are with respect to the impact of those tax cuts, and let me just maybe broaden the question a little bit, in the sense of saying, or asking further.

You mentioned that you saw a trend line, an increasing trend of taxation as a percentage of GNP, and I wanted to ask you whether you saw that increasing trend as being a negative to the economy.

I think that frames the question well enough.

Mr. TAYLOR. OK, the first part of your question, I certainly did mean to give the impression earlier that I thought the tax cuts were the cause of the budgetary problems in the early 1980's. The way I think about it is that the tax cuts kept taxes as a share of GNP from growing further.

Senator MACK. Was that good or bad, or can you——

Mr. TAYLOR. And then the second part of your question, is that good or bad, I think that the lower marginal tax rates which came about in the 1980's are a great improvement in economic efficiency, will lead to better allocation of leisure and work and be a general stimulus to economic growth in the long term. I think that is a very important positive aspect of reducing the tax rates in the United States, which came about during the 1980's.

Senator MACK. Let me just take it a step further. Knowing what we know now, would you encourage or do you believe that those tax cuts were the right thing to do?

Mr. TAYLOR. I believe they were the right thing to do. I wish they were matched with appropriate changes on the spending side at the time, and what adjustments will actually occur in the future of course is not my decision. It is the decision of the negotiations which are still in process.

But just to reiterate, I think the increase in the deficit that we saw in 1981 and 1982, a large part of it came about as a result of that recession that we had at that point. If we hadn't had that recession—and it wasn't forecast. Nobody forecasted a recession of that size—we would not have seen the deficit grow to that large amount.

Now, of course we are well beyond that recession, and we are close to full employment, and the remaining deficit is structural and we need to get rid of it.

Senator MACK. Do you believe that the changes in taxation or the tax cuts helped to stimulate the economy?

Mr. TAYLOR. I believe the reduction in marginal tax rates helped stimulate the supply side of the economy, yes.

Senator MACK. OK, let me switch now to the area in which I guess you spend a fair amount of time. That is the international area.

The comments have been made that in essence the Government deficit went a long way in creating the imbalance in our balance of payments and that the approach that we should take if we are going to solve that problem is we reduce the Federal deficit and that should help us with our balance of payments, and let me expand the question a little bit more.

Also, I would like to get your reaction as to the role of—I refer to it as Super 301. Is it in fact the Federal deficit that created our trade problem, and in addition to that, then, if that is not the case, what role does the Super 301 play in helping solve our trade problem?

Mr. TAYLOR. The budget deficit and the trade deficit, saving and investment are all interrelated, and I hope not to sound too much like I want to mess up and complicate the picture. But the budget deficit is only part of the trade deficit. The other part of it is low personal saving. The Government is dissaving and the private sector is not saving as much.

So those two things together, and when we cut the budget deficit, I don't think it is right to think that that will be a dollar-to-dollar improvement in the trade deficit. It will certainly improve the trade deficit, but it is not a one-to-one effect.

Senator MACK. It seems to me one of the important things—I mean, if there is a free flow of capital—which there seems to be somewhat of a free flow of capital, that some of the money is flowing back in, it is funding our deficit—it seems to me that it is more important how we invest the dollars that we get through savings, whether that is taking someone else's savings or whether it is using our savings.

Is that a fair statement?

Mr. TAYLOR. Yes, sir, it is a very fair statement. The concern is that the U.S.—Americans are not benefiting from the investment. Rather, it is foreigners, and that is a concern for Americans as individuals.

Senator MACK. Can I interrupt you there for a second?

Mr. TAYLOR. Yes.

Senator MACK. I mean, I think I get the drift of the economic response. Certainly, the fellow that is out there, man or woman, that is employed today in a Toyota plant feels that there is in fact a benefit to foreign investment.

Mr. TAYLOR. Yes, sir, definitely.

Senator MACK. So I mean, it is not——

Mr. TAYLOR. The benefit to Americans from foreign investment is much like the benefit from any investment, whether it is foreign or domestic. We learn more how to do things. There's technological improvements when new investment occurs, and that will occur whether it is foreign or domestic, and in some cases in the case of foreign investment it will occur more because we are learning new methods of management or new techniques. Economists like to use the word "externalities," something that flows beyond the investment per se, but benefits the economy more generally, and that occurs regardless of the source of the investment. So it is an important aspect of investment.

Senator MACK. Mr. Chairman, could I just follow up with one more question?

The CHAIRMAN. Please do.

Senator MACK. And I apologize.

I want to get back to that point, though, about it is what we do with the savings that—I mean, it is your concern—and I think I have heard it from many, many others, obviously, that the concern is that the savings rate in this country is too low. If we increase

the savings rate in the country, double it, but we don't do the right kinds of things with it, we really haven't accomplished the end result; that is, a faster growing, more productive society, I assume.

Mr. TAYLOR. That is right, that is right. But I would assume that the capital markets are working efficiently enough that those increased funds will be put to productive uses in the most efficient way possible, and so whether they are or aren't depends on how the new capital is allocated, and my view of the American capital markets is that those funds will be allocated efficiently.

Senator MACK. OK. I am not being argumentative. I am really trying to learn here.

Mr. TAYLOR. I understand.

Senator MACK. The capital markets are in essence providing us with the savings that we need to do the things that we are doing today, and what I am suggesting to you is that maybe the emphasis ought to be more on not what do we do to increase savings but what we need to do to use those savings more effectively. I guess what comes to my mind is that this is not the first time that the United States was a debtor nation.

Mr. TAYLOR. That is right.

Senator MACK. And I think that in, what, the early 1900's, late 1800's——

Mr. TAYLOR. That is right. The building of the railroads across the United States was foreign financed.

Senator MACK. So we took those savings from abroad and we put them to use in building a capital structure or productive capacity of our country; whereas, today we are taking those foreign savings and really using them for consumption.

Mr. TAYLOR. To the extent we are using them for consumption, they are not going to pay off in the future. There is no question about that, Senator. But the extent that they are used for investment, which they are to a large extent, the increased savings won't be going into consumption. The increased saving will be going to investment.

I have no reason to believe that we need to think about reallocating that new savings to investment in a different way than it is occurring already. I think the allocation of any increased saving, which by definition will be to investment, not to consumption, will be efficient, and so we don't have to worry about the possibility of it going into consumption.

It could actually reduce the amount by which foreigners invest in the United States. So that will be a switch from foreigners building plants to Americans building plants, and that will affect to some extent these externalities I spoke of earlier, but have a beneficial effect on the economy.

Senator MACK. OK. Thank you, Mr. Chairman.

The CHAIRMAN. Before yielding to Senator Kassebaum, just on this point, this is exactly what this committee needs to do and should be doing and I think has done too little of in the past. Our principal charter as a committee is to really understand the economic position of the United States in a financial and monetary sense—where we are, where we are going, what are the trendlines. I would say, looking back over recent years—this is my 13th year

on the committee—that we would get about a 2 on a 10-scale in terms of our serious attention to those issues.

I say that, not to try to find fault with anybody but only to point out that if this committee doesn't really deal with these questions there is not another appropriate committee that steps in and does it.

There is just a big gap in the kind of serious inquiry and sort of policy thinking that the legislative branch needs to do in conjunction with the other branches of Government.

I think we should use the occasions, not just confirmation hearings, but other serious hearings we will have, particularly on the Defense Production Act reauthorization, which will come later this year, to really get into the guts of these questions of what does it mean that we were last a debtor nation in 1917, and, as you say, earlier than that, though that was in an entirely different world. It was a time when we were not carrying the free world's defense burden to the extent we are today.

What does it mean when 60 years later we go back into a debtor nation position and then are really riding that curve down at the rate of $1 billion every 3 days?

I have a chart that illustrates that, but it looks like an airplane with the wings off in terms of the rate of descent that we are going into this debtor's hole.

I think the serious inquiry of serious people is fundamental to understanding what these new realities are, and I don't know that there are fixed reference points.

Economic theories that we may all have studied in good universities are helpful to a point, but as the world reconfigures itself, I think it is going to take new thinking and a certain amount of pragmatism and adjustment and not necessarily an overdose of ideology.

Obviously, we want freedom and things that fit our basic values, but I think the search for an understanding of the changed economic policy mix is really the first order of the day, and once we can get reality pinned down then I think we can start to frame up what our choices might be.

And so I very much appreciate the questions that you are raising, and I am hopeful that we can really make some progress on these issues.

Senator Kassebaum.

Senator KASSEBAUM. Thank you, Mr. Chairman.

Dr. Taylor, I am very impressed with your comments and I think the country will be well-served by having you as a member of the Council of Economic Advisers. In fact, I am looking forward to going back and reading some of your work at this point.

I would like to just jump for a moment to monetary policy. The Plaza Agreement has seemed to work relatively well as far as stability in the markets and the G7 Group being willing to make the tradeoffs and actions necessary to keep some stability.

On the other hand, it can certainly swing rapidly.

Do you see any merit—and I am not a gold standard person—but do you see any merit in trying to think about finding some way to have a more uniform structure in our financial system?

Mr. TAYLOR. I think rather than think in terms of a gold standard or that kind of a structure that the most important thing for the Federal Reserve and for the Government in general to be thinking about is an aim to stabilize prices and keep inflation low in the United States, and that goal will lead to more growth and a healthier economic environment if met.

If other countries have similar goals of price stability and are successful in achieving those goals, that will bring about stability in exchange markets to a large extent itself. Maintaining a sort of similar amount of inflation in each country will—hopefully as close to zero as we can eventually will bring about more stability in the exchange markets.

As you point out, there are still instabilities which will occur, and some of those, like any market, we will probably have to live with. If they are small, they are not going to be harmful. Others—there's the agreements like the G7—will make them less of a problem.

Senator KASSEBAUM. What, for instance, would have been the consequences—I think it was about 2 weeks ago—when the dollar soared rapidly and the Bank of Tokyo jumped in and helped stabilize? What if they had decided not to enter in at that point?

Mr. TAYLOR. The extent of the stabilization—their evidence shows it has some small effect on the exchange rates. So my presumption would be if they had done less intervention there would have been more movement in the exchange rate. I actually do not know how much intervention occurred. I don't have that information, but if there were less of it I presume that, at least in the short run, that the dollar would have risen further.

The statistical studies that have been done on the effect of intervention in exchange markets are quite interesting, and there has been much of it in the last few years, which I think it is going to be useful for us in deciding what kind of structures we should be thinking about for the international monetary system.

Much of those studies suggest that intervention in the markets, if it is not—if it is sterilized, to use the technical monetary term, has a fairly small effect. Other studies show it has more of an effect. But I think we have to realize that the statistical data shows that those interventions have a modest effect on the exchange rates.

Senator KASSEBAUM. If I may just ask you your thoughts on 1992.

If 1992 progresses ahead as hoped—and I would personally think it will be a long time before there is ever a European monetary system—but do you see it, even in its beginning phases, as having some impact on a need for a more coordinated monetary policy, or is it relevant at all?

Mr. TAYLOR. I think the efforts to reduce trade barriers, flow of individuals, flow of capital will not in itself require a new international monetary system.

There is a question about how much exchange rate stability is required within Europe, and if there is a commitment to the European monetary system and its capital flows are increased, there will have to be increased coordination amongst the European central banks. It is just that that is required in order to maintain the exchange rate stability.

But basically the improvements in the markets in 1992 I think are very favorable for the U.S. economy as long as barriers against the U.S. economy are not erected as a result of 1992, and we should work very hard to see that that doesn't occur. But I think there will be more business opportunities, more opportunities for American business in Europe as a result of 1992 because of this integrated market.

Senator KASSEBAUM. I do, too. I think it is an exciting challenge really.

Just one other thing on the——

The CHAIRMAN. Could I—I hesitate to interrupt, but I think what we should do here in light of the fact that we have set a time to establish a quorum is to pause here, have Dr. Taylor suspend his session with us, and take up Mr. Farren so we can have Mr. Farren presented to the committee and make his opening statement. Then, when we have completed that part and we have conducted our quorum vote, we can resume questioning with Dr. Taylor. I have other questions I would like to raise, and I know you have at least one more.

Would that be agreeable with you, Senator Kassebaum?

Senator KASSEBAUM. Yes, Mr. Chairman.

The CHAIRMAN. Dr. Taylor, if we may, let me ask you, if you will, to wait for the time being and remain in the room because we want to come back to you here. Let me call Mr. Farren to the table.

We are pleased to have Mr. Michael Farren with us, also, this morning, who has been nominated to be the Under Secretary of Commerce for International Trade. As such, he will have major responsibilities for assisting in developing our Nation's international trade policy and for implementing that policy in negotiations around the world. He will represent the Department of Commerce on the Interagency Trade Policy Review Group, which is the major sub-Cabinet forum in which trade policy is formulated in the executive branch.

The importance of this position to our national well-being has increased as our economy has become increasingly integrated into the world economy and the ability of important American industries to compete effectively, both at home and abroad, is influenced by trade policies adopted by our Government and those of other governments with which we trade.

Commerce Department matters that will fall under Mr. Farren's overall responsibility include both protecting domestic markets from predatory trade practices and also prying open foreign markets now closed so that our industry has a fair chance to sell abroad. These duties involve the jurisdiction of both the Senate Finance and Banking Committees.

I want to particularly thank Senator Bentsen, Chairman of the Finance Committee, for agreeing to give this committee a sequential referral of Mr. Farren's nomination. It provides an opportunity for us to question Mr. Farren as to how he will exercise his duties in the trade promotion matters over which we have the direct jurisdiction.

So I welcome him to this hearing and invite him to make whatever opening comments he would wish to make, and let me do as I

did earlier and administer the oath to you now before you begin your comments.

[Witness sworn.]

The CHAIRMAN. Do you agree to appear and testify before any duly constituted committee of the Senate?

Mr. FARREN. I do.

The CHAIRMAN. Very good.

We would be pleased to have you make any comment now, Mr. Farren.

TESTIMONY OF JOHN MICHAEL FARREN, OF CONNECTICUT, TO BE UNDER SECRETARY OF COMMERCE FOR INTERNATIONAL TRADE, VICE W. ALLEN MOORE, RESIGNED

Mr. FARREN. Thank you, Mr. Chairman.

I do not have a written statement, but I do want to thank you particularly, and the committee overall, for bringing my nomination up so quickly. I also want to thank Senator Dodd for having introduced me yesterday at the Finance Committee hearing. I appreciate it a great deal.

Senator DODD. Well, I just want to take advantage of that. Again, I will not give you the same introduction here that I gave yesterday, but let me just say to my two colleagues who are here that Michael is—we are very proud of him in Connecticut. He has done extremely well. He has served now on a number of occasions in public service.

He was the deputy of the position he now has been nominated for. He was the counselor to Mac Baldrige. As I said yesterday—and I will repeat this—in the Finance Committee, we are getting almost a proprietary interest in the Commerce Department on trade issues, with Mac Baldrige, and Bruce Smart, and others over the last several years who, I think everyone agrees, did just a first-rate job on trade questions.

Michael has moved through the chairs, in a sense, in that agency, having been counselor, then deputy, and now nominated for the position here. He really understands the issues extremely well.

We have some sensitivity to the issue of trade in Connecticut, Mr. Chairman. I would tell you, we are the most dependent State in the country, on a per capita basis, on exports, which is not widely known. Again, there are larger volumes in, obviously, California, Texas, or elsewhere, New York; but on a per capita basis, Connecticut is the most dependent. So we are particularly trade-sensitive in the State.

Again, I am very confident that the nominee is going to be a credit to our country, and will be a real fighter on these questions. He has already demonstrated his ability in the area.

So I am pleased once again to present you to another committee.

Mr. FARREN. Thank you, Senator.

Senator DODD. On this one, I actually get a chance to vote on you, Mike.

Mr. FARREN. Great.

Senator DODD. On the other one, I could just use my—extensive influence with the Finance Committee.

The CHAIRMAN. I get tc vote on you twice, in effect. [Laughter.]
Senator DODD. That's double-jeopardy there, I think. [Laughter.]
The CHAIRMAN. Thank you very much, Senator Dodd.

Let me have any opening comments you wish to make in addition, Mr. Farren.

Mr. FARREN. Mr. Chairman, I am honored by the President's nomination. I look forward to working with Secretary Mosbacher. I have enjoyed my 4 months there already. I believe that he has set an appropriate course for the Department, as a very proactive participant in the establishment of trade policy, and has established as a high priority the assistance to American business and promoting exports and taking advantage of global markets around the world.

So I look forward, if confirmed by the Senate, to taking on the duties and the task as Under Secretary for International Trade.

The CHAIRMAN. I am going to ask you a couple of questions here. On March 4 of last year, the New York Times carried an article about you—you may recall it—that discussed inside rumors that lobbyists from the Japanese had intervened with the White House to try to block your appointment as Under Secretary for International Trade in the Commerce Department, during then-Secretary Verity's stewardship at Commerce. The story relates that those lobbyists opposed you because you were too tough in your negotiations with Japan. I am sure you will recall that story, and other stories like that at the time.

Were you aware of such rumors, and do you think there was any truth to them?

Mr. FARREN. Senator, I was aware of the rumors, I recall the article. I do not know of any truthfulness to the rumors, except the fact that people indicated that they believed them to be true and they were reported at the time in the newspapers. But directly, no, I have no knowledge of their validity.

As a negotiator, I believe I was fair and direct, and I made a point of defending U.S. interests in discussions with the Japanese, and that is the way I would expect to operate in the future.

The CHAIRMAN. Mr. Norman Augustine, who is the CEO of the Martin-Marietta Corp. and Chairman of the Defense Department's Policy Advisory Committee on Trade, recently testified before the Senate Arms Services Committee. In his prepared testimony, he said the following:

> One troubling global trend that needs policy focus is the practice by some countries of targeting industries critical to defense and national security. When a country selects one or more specific industries for development, subsidizes those industries to whatever extent necessary to be competitive, and establishes a world-wide strategy to gain market share at all costs, then it is impossible for a competing U.S. company, in and of itself, to remain competitive within the borders of the United States.

I think that is a very solid sort of assessment by a person in a position to make such an assessment. Do you share that concern that Mr. Augustine has expressed, that some targeting of U.S. industries is taking place?

If that should be the case, what kind of national response do you think we ought to have for those practices if they occur or are occurring?

Mr. FARREN. Senator, I believe that, in many instances, we do see the effects of an individual national industrial policy in the global market, and also in our own domestic market.

I believe that there is a growing number of industries where the American private sector is not simply competing against the private sector of a foreign nation, but actually against the foreign government.

I do not believe that we have yet established an appropriate policy to approach that. It should be one that is adopted on a multilateral basis. I believe some of the discussions in GATT will take on many of those issues. I believe it is one that this administration is going to have to grapple with in the next few years.

The CHAIRMAN. I have a number of questions related to our competitive position and our ability to strengthen ourselves. I am going to put some of those questions to you for the record, rather than in the course of the hearing this morning.

Let me acknowledge the presence of Senator Garn, and also of Senator Pressler who joined us, and Senator Dodd who has joined us.

Senator Kassebaum, did you want to pose a question to Mr. Farren at this point?

Senator KASSEBAUM. No questions, Mr. Chairman.

The CHAIRMAN. Let me inquire of Senator Pressler. Do you have any comments you want to make about this nominee, or the previous nominee, or to raise questions?

Senator PRESSLER. No, except that I'm going back and forth between here and Foreign Relations. They want a living, breathing Senator in each place—not necessarily a thinking one [laughter] so are we going to vote at 11:15?

The CHAIRMAN. Yes, we are. The minute we have a quorum present. And other members are coming as we are seeing here, because we have tried to set a time to accommodate people's needs to be several places at once.

Let me call on Senator Garn. Senator Garn, do you have any comments you want to make about the nominees today, or any questions you want to address to Mr. Farren?

Senator GARN. Thank you, Mr. Chairman.

No, I do not. I apologize for not being here, but I have been in a mark-up in the Rules Committee, and so has Senator Dodd.

The CHAIRMAN. Senator Dodd, did you have any comments or questions you wanted to address to Mr. Farren, or anything that might relate either to our earlier witness, who we will be bringing back when we finish with Mr. Farren here?

Senator DODD. No, Mr. Chairman. I am going to have plenty of opportunity in the coming weeks and months to get into some specific, substantive areas and questions.

I am very interested in seeing—it is not really much as a question, but if he wants to comment, he may. But I would very much like to see some thought given to the changing of the Department of Commerce to a Department of International Trade and Commerce, where we recognize that we are about to enter into the 21st century, and shed the notion that somehow the Department of Commerce seems to conjure up, and the problems we have seen with how many bases you have to touch when it comes to interna-

tional trade questions, and how often the Department of Commerce ends up getting the sharp elbow in the ribs, when Defense or State or others seem to really control the trade questions.

I think there is an important role they play there, but at some point or other we are going to have to catch up and elevate, it seems to me, the status of international trade to a level where that entire department is almost focused on that; and to a secondary and ancillary degree, the commerce questions internally, which must be addressed.

I know Mac Baldrige advocated that. I strongly supported him in that. We could not get anybody to listen to him, unfortunately. I remember the fights he used to have every time he would come up with something. There was a meeting—I think, was it 9, or 10, or 11 different stops that he had to make, when it came to a question of trade. It was just that every single time there was the slightest controversy, the Department of Commerce would always get short shrift on those questions.

As I say, I do not disagree that the other bases need to be touched, but that is not a way to be doing business. I do want to comment on that notion. You are free to. If not, we will address it another time.

Mr. FARREN. Senator, I spent a lot of time working on that issue with Secretary Baldrige, so I am very familiar with the aspects of it, and the advantages that could come of it.

I believe Secretary Mosbacher has brought the view that in the short term, particularly with the implementation of the trade bill and the pending issues, he would like to be able to focus on those issues and not reorganization. But I think in the long term, all the points that you made certainly warrant further consideration.

The CHAIRMAN. I have indicated to colleagues who are in a number of locations right now—because the Senate is in session and we have matters before the Senate on the floor and we have other committees meeting—that I will very shortly move the approval of these nominations to be sent affirmatively to the Senate floor, and will leave the vote open for a period of time, as other members come, so that we establish clearly the presence of a quorum in terms of the votes actually cast here in the room.

I think that may be the best procedure to follow today, because I want to accommodate the requirements all the way around. So I will now move that we approve the nominations of the two nominees that are before us today, of Mr. Taylor to be a member of the Council of Economic Advisers, and Mr. Farren to be the Under Secretary of Commerce for International Trade.

We will hold the vote open here for the next few minutes, as we assemble a quorum. Also, there are two others that we will be voting on this morning on whom we have previously held the hearings. Those are Alfred Dellibovi of New York, to be Under Secretary of Housing and Urban Development, and Ms. Susan Schwab of Maryland, to be Assistant Secretary of Commerce and Director General of the United States and Foreign Commercial Service.

Senator DODD. Is that en bloc, Mr. Chairman?

The CHAIRMAN. So I would entertain——

Senator DODD. I will so move.

Senator GARN. Mr. Chairman, I have no objection to that procedure, but as far as Mr. Taylor and Mr. Farren, I suggest you ask unanimous consent to waive the committee rules, because their hearing has just been completed, and waive the time in the committee rules so that we could consider them along with the other two.

The CHAIRMAN. That is good advice. I would ask unanimous consent that we waive the time requirement rules with respect to Mr. Taylor and Mr. Farren, so that we are in a position to vote on those nominations today.

Is there objection?

[No Response.]

The CHAIRMAN. Hearing none, they are so waived.

Senator DODD. I will renew that motion, Mr. Chairman.

The CHAIRMAN. The request has been made that we vote on all of the nominees en bloc, by Senator Dodd. I am prepared to do that. I think we should, however, indicate that any member who arrives and wants to be cast in the negative on any specific nominee can be so recorded.

Would you amend your request to that degree?

Senator DODD. I so amend my request.

The CHAIRMAN. All right. Then I think what we will do is, we will ask the clerk in a moment to call the roll, and we will be voting en bloc on all four at once here, with the understanding that, if any member wishes to be recorded in the negative on any specific nominee, it will be so done.

Is there objection to that request?

[No Response.]

The CHAIRMAN. Hearing none, then that will be the manner in which we proceed.

[Pause.]

The CHAIRMAN. While we are waiting for our members to come in and take their seats—we are rapidly assembling our quorum here—I want to draw everybody's attention to the play-off game tonight with the Pistons on national television [laughter] if you did not see the game on Tuesday night, you really missed a terrific game. I would like to just encourage you, if you like pro basketball even a little bit, to tune in tonight, because it ought to be really a terrific game.

Senator DODD. Well, do you want to tell us when this ends, the pro basketball? I mean, it is now July.

Senator PRESSLER. Yes, I thought it was baseball season.

Senator DODD. It is baseball season. I remember the days when this was over with, in April.

Senator GARN. Where the Pistons are concerned, it does go into the NFL football seasons, if you watch them.

Senator DODD. Yes, it does. Well, the Utah Jazz did so well, I mean [laughter].

Senator GARN. You know, the original choke—best season they have ever had, 51 victories, and choke. [Laughter.]

The CHAIRMAN. With that, before this gets totally loose, let me ask the clerk to call the roll on the vote on the nominees en bloc.

The CLERK. Mr. Chairman.

The CHAIRMAN. Aye.

The CLERK. Mr. Cranston.
[No Response.]
The CLERK. Mr. Sarbanes.
The CHAIRMAN. He is voting "Aye" by proxy.
The CLERK. Mr. Dodd.
Senator DODD. Aye.
The CLERK. Mr. Dixon.
[No Response.]
The CLERK. Mr. Sasser.
[No Response.]
The CLERK. Mr. Sanford.
The CHAIRMAN. Senator Sanford is "Aye" by proxy.
The CLERK. Mr. Shelby.
The CHAIRMAN. He is "Aye" by proxy.
The CLERK. Mr. Graham.
The CHAIRMAN. He is "Aye" by proxy.
The CLERK. Mr. Wirth.
Senator WIRTH. Aye.
The CLERK. Mr. Kerry.
The CHAIRMAN. He is "Aye" by proxy, as well.
The CLERK. Mr. Bryan.
The CHAIRMAN. He is "Aye" by proxy.
The CLERK. Mr. Garn.
Senator GARN. Aye.
The CLERK. Mr. Heinz.
[No Response.]
Senator GARN. He will be right back.
The CLERK. Mr. D'Amato.
[No Response.]
The CLERK. Mr. Gramm from Texas.
[No Response.]
The CLERK. Mr. Bond.
Senator BOND. Aye.
The CLERK. Mr. Mack.
Senator MACK. Aye.
The CLERK. Mr. Roth.
Senator ROTH. Aye.
The CLERK. Mrs. Kassebaum.
Senator KASSEBAUM. Aye.
The CLERK. Mr. Pressler.
Senator PRESSLER. Aye.
The CLERK. Fifteen "Yeas."
The CHAIRMAN. Senator Kerry is present as well.

I am told that other members are coming up from the Foreign Relations Committee, where they are in the midst of a hearing.

[Pause.]

The CHAIRMAN. The clerk will announce the vote.

The CLERK. It is 15 "Yeas," no "Nays."

The CHAIRMAN. The vote is 15 "Yeas," no "Nays." The vote will remain open for the next several minutes, so that other members who are en route can be recorded.

Let it be noted that we have had a quorum present, a physical quorum present, so the committee will report favorably on the nominations, as the committee has just done.

Now, let us resume here with Mr. Farren. Do any of my colleagues have questions that they want to address to Mr. Farren? Senator Pressler, do you have any questions you want to address?

Senator PRESSLER. No, Mr. Chairman.

The CHAIRMAN. Senator Bond?

Senator BOND. I might just renew a question—and I apologize for having been absent for your testimony—a question I asked earlier. Do you think we are exercising, or that we are doing a good enough job in promoting exports? Could we do a better job, could the US&FCS?

Mr. FARREN. Yes, Senator, I believe we can do a better job. If confirmed, it would be my intention to take that on as a primary task.

Senator BOND. Well, that kept me from switching my vote. Thank you, I appreciate that.

Do you have some specific ideas, though?

Mr. FARREN. Senator, we have been working over the last few years at the Commerce Department, when I was there as Deputy Under Secretary, to try to maximize use of State and local efforts, and frankly get trade associations more actively involved.

Basically, a lot of those resources are to serve as a multiplier of the talent that the Commerce Department already offers in the way of services, and to do a better job than we have in the past of really pulling that together into a concerted effort. That would be the first task I think we should undertake.

Senator BOND. As a former Governor—and many of my fellow colleagues, former Governors, in the Senate I think have been actively engaged in those efforts. I would say that we have been very discouraged by the lack of resources and the lack of the direction of the US&FCS.

What do you think about using your overseas personnel in trade policy matters?

Mr. FARREN. Well, Senator, in many instances the overseas personnel have been an important element in trade policy matters, in terms of gathering information. That has been particularly the case, for example, in Japan.

Senator BOND. Korea, as well.

Mr. FARREN. Yes. With George Miule in Korea. I believe we can do more of that, particularly, for example, in Europe, as EC 92 comes down, being able to watch exactly how that is being approached, knowing what is happening on the ground.

The U.S. and Foreign Commercial Service is just a tremendous resource, not just overseas but also domestically, to know what the problems are that individual business firms are confronting and in trying to translate those into an overall administration position in dealing with them, particularly when it involves distortions in the marketplace or constraints on opportunities in individual markets.

Senator BOND. What about using them actually as negotiators? I think I would agree with you that their role as information gatherers is very important. Do you see any conflict between their role as negotiators, and as trade promoters?

Mr. FARREN. Senator, my view would be that it is very difficult for someone on the ground, who has an ongoing responsibility, to be a negotiator, particularly on a contentious issue. Frankly, it is

better for someone to come in from Washington, represent the Government's position, and be able to leave, and have more constancy in the sense of the role of the commercial officer on the ground.

Frankly, some of these negotiations do get contentious, and it is better for them to be outside of that battle.

Senator BOND. Exactly, that is my point. It is tough to suck and blow at the same time.

Mr. FARREN. Yes.

Senator BOND. And when you get somebody who is trying to be a promoter, who is working to gain markets and to be a good salesperson, to have them beating the potential clients, the potential buyers, over the head is a very bad idea.

Mr. FARREN. That is right.

Senator BOND. We will be giving the Commerce Department a copy of the legislation that we will be introducing shortly, breaking out various parts of it. It does play very heavily on trying to give a mission to the US&FCS, trying to encourage more resources for it, utilizing the resources that we have better. We would welcome your Department's comments on it and any guidance you can give us.

Mr. FARREN. Senator, I look forward to seeing it, and I look forward to being able to talk to you about it.

Senator BOND. Thank you, sir.

No further questions, Mr. Chairman.

The CHAIRMAN. Thank you very much, Senator Bond.

Senator D'Amato, we have acted en bloc on all four nominees, one of course you had a particular interest in, and that was Mr. Dellibovi. Mr. Farren is at the table now. We are going to be calling our other witness back, Mr. Taylor, in just a moment.

Did you have a comment that you wanted to make?

Senator D'AMATO. No, Mr. Chairman. I would, though, like to be recorded as voting "Aye" for the four nominees.

The CHAIRMAN. You will be so recorded.

Senator D'AMATO. I thank you for keeping the vote open.

The CHAIRMAN. Thank you. Good to have you here.

Are there any questions, Senator Garn, of Mr. Farren?

Senator GARN. No, I have none, thank you.

The CHAIRMAN. Mr. Farren, I am going to ask you just one other question, and then we will give you the remainder to answer for the record.

During her confirmation hearing last week, Assistant Secretary-Designate Susan Schwab told us that the Commerce Department had sought the permission of the State Department to assign Foreign Commercial Service officers to the U.S. mission to the European Community in Brussels, in order to monitor the developments of regulations that will implement Europe 1992, obviously a very key issue for us and for American companies and workers and our whole economic system.

Apparently, the State Department has not responded. Can you tell us what the problem is on this, and how quickly you think it can be resolved?

Mr. FARREN. Mr. Chairman, I learned this morning that apparently a response has come back to the Secretary just within the last day or two from Secretary Baker.

The CHAIRMAN. Hopefully, an affirmative one?

Mr. FARREN. Well, it is my understanding that the Secretary indicated that he would wait for Ambassador Niles, who has been nominated for that position, to arrive in Brussels and make a determination as to how to increase the staff and deal with the commercial responsibility in the mission.

It is our strong hope that Ambassador Niles will reach the conclusion that we should increase the staff, and the staff should be comprised of commercial officers operating under the Department of Commerce.

The CHAIRMAN. I think it is crucial. I hope we will not run into any kind of just bureaucratic delay or bureaucratic elbowing, or things that can go on. Because it is a big, tough, competitive world out there. As Europe gets ready to come on-line in a unified way, I think we have really got to get present out there and active in making sure that our own interests are being looked after.

So I know you share that view, but I would urge you to be very active on this issue. I would appreciate it if you would keep us informed as to whether we have gotten this issue resolved, or if we are snagged in some way.

Mr. FARREN. I will, Mr. Chairman.

The CHAIRMAN. With that, I thank you for your testimony this morning. I am going to now excuse you as a witness, and ask that you give us prompt answers to the questions that we will be submitting to you for the record.

Mr. FARREN. I certainly will. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Mr. Farren.

Senator HEINZ. Mr. Chairman, might I be recorded?

The CHAIRMAN. You certainly may.

Senator HEINZ. Aye.

The CHAIRMAN. Very good.

Senator HEINZ. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Heinz.

Mr. Taylor can I ask you now to come back to the table?

The CHAIRMAN. I appreciate your flexibility.

Mr. TAYLOR. No problem, Senator.

The CHAIRMAN. I hope the fact that we are going to continue for some additional discussion here will be an important sign and signal to you of the seriousness with which we take your appointment, your work on the Council, the work of the Council as a whole. The fact that the committee will be very actively engaged in thinking with you and working with you and the Council on trying to map out the question of what constitutes the best kind of national economic strategy for us to be pursuing.

I want to go into two or three areas with you in the time that we have left today. The first thing that I want to discuss will go back to an earlier exchange that we had this morning. I refer to your book on macroeconomics. I want to just read directly from it, on page 272 and page 273, where you say the following—and this is not in an effort to try to sort of have a ideological debate. I just want to get two or three sort of basic ideas out on the table and have an exchange on those ideas.

You say on page 272, under the heading "The Budget Deficit And The Trade Deficit," the following—and I will just read it to you as

the basis for the questions that I want to pose—you wrote as follows:

What happens to the trade deficit when the Government runs a fiscal budget deficit? Suppose the budget deficit comes from a large tax cut that puts much more disposable income in the hands of consumers. There is no corresponding reduction in Government spending, and consumers choose to spend most of the increase in disposable income. Then the IS curve shifts outward, the interest rate rises, the dollar appreciates, and net exports decline; thus, a budget deficit causes a trade deficit.

And then you go through another paragraph here, when you key back to something you had said in an earlier chapter.

The accounting identity we studied in chapter 2 suggests that there should be a relation between budget and trade deficits. Funds available for investment in the United States are private savings, less the Government deficit, plus the capital inflow from abroad. Unless an increase in the budget deficit depresses investment significantly, it will have to cause a capital outflow.

So let's grant that. Then you get to this, which I take to be the punchline. You say:

U.S. experience in the 1980's demonstrated this principle on a grand scale. The following chart shows how the tax cut of 1981, with large spending cuts, brought about a gigantic budget deficit. From trade surpluses at the beginning of the decade, very large trade deficits emerged in 1984, 1985, and 1986. The budget deficit causes an accumulation of Government debt. In a closed economy, the nation owes the debt to itself, but when the budget deficit is financed through a capital inflow, the borrowing is from the rest of the world. In effect, the United States owes the part of the national debt accumulated since 1981 to Japan and the other countries that have financed the U.S. trade deficit by running trade surpluses.

[Material referred to above follows:]

The Budget Deficit and the Trade Deficit

What happens to the trade deficit when the government runs a fiscal budget deficit? Suppose the budget deficit comes from a large tax cut that puts much more disposable income in the hands of consumers. There is no corresponding reduction in government spending, and consumers choose to spend most of the increase in disposable income. Then the IS curve shifts outward. The interest rate rises. The dollar appreciates and net exports decline. Thus a budget deficit causes a trade deficit.

The accounting identity we studied in Chapter 2 suggests that there should be a relation between budget and trade deficits. Funds available for investment in the United States are private saving less the government deficit plus the capital inflow from abroad (the trade deficit). Unless an increase in the budget deficit depresses investment significantly, it will have to cause a capital inflow.

U.S. experience in the 1980s demonstrated this principle on a grand scale. The following chart shows how the tax cut of 1981, with large spending cuts, brought about a gigantic budget deficit. From trade surpluses at the beginning of the decade, very large trade deficits emerged in 1984, 1985, and 1986.

The budget deficit causes an accumulation of government debt. In a closed economy, the nation owes the debt to itself. But when the budget deficit is financed through a capital inflow, the borrowing is from the rest of the world. In effect, the United States owes the part of the national debt accumulated since 1981 to Japan and the other countries that have financed the U.S. trade deficit by running trade surpluses.

Trade deficits are not the inevitable result of budget deficits. In the mid-1980s, Japan had a budget deficit even larger than the one in the United States, but Japan had a trade surplus. The explanation is the remarkably high rate of saving of the Japanese. Private saving in Japan is enough to finance a large volume of investment, a huge government deficit, and leave enough left over to make large investments in U.S. government debt and other forms of lending to the United States.

And then you go on in this vein. It is very thoughtful and coherent, and I follow, I think, what you are presenting here, and would tend to agree with it.

Now, here is the question that I really want to pose to you. If we find that we have got a base level of government spending that is going to go on—peg it at whatever level you will—some may say it is too high, some may say it is too low, some may say it is just right; but if that is the amount of government spending that we end up actually doing, is it sound to try to have an amount of revenue that is roughly equal to what we are spending year-in and year-out, so that we are not accumulating these big deficits?

Mr. TAYLOR. Roughly equal is the way I would put it, Senator, yes. But that would allow, of course, for some increases in the deficit and recessions to help mitigate the seriousness of the recession, and perhaps allow for some surpluses in boom periods.

The CHAIRMAN. Right.

Mr. TAYLOR. That would be the ideal. I would leave that amount of flexibility in the budget.

The CHAIRMAN. Exactly. In other words, we want to have the flexibility to be able to have some countercyclical strategies, if we get hit with conditions that maybe require more Government spending to stabilize the economy, to counteract a recession, or we want to save more during boom times so that we do not spiral off into an inflation and so forth. We want to have the ability to try to work off what normally we would shoot for, which would be a balance, a rough balance, between revenues and expenditures. Is that right?

Mr. TAYLOR. Yes. I would add that many of the changes through which taxes are adjusted over the business cycle are automatic, having to do with what we call automatic stabilizers.

The CHAIRMAN. Right.

Mr. TAYLOR. Really not requiring specific Government action.

The CHAIRMAN. Right. We have taken a lot of those away, by the way.

Mr. TAYLOR. We have taken—we have streamlined, with the tax reform, the less progressive tax does mitigate the extent to which the tax system automatically is adjusted. That is correct.

The CHAIRMAN. Now, if we go back to the 1981 period, it seems to me that, looking backward, what we found was that Federal Government spending took place at a certain level.

There was a hot debate as to whether it could be reduced more, or should be higher, or what-have-you. But the collective decision, with the President being part of it, was that we got it "down," or we got it to the point that it was the amount that we all would agree on, and there did not seem to be a way to save any more money. Certainly, we did not manage to do so from the spending side.

But we have locked in the tax cuts. The tax cuts, given the pace at which the economy was functioning, gave us a reduced stream of revenue coming into the Government. As you seem to be saying here, what happened was that the mismatch between the level of spending on the one side and the tax receipts on the other, which were substantially lower than the spending we were doing, left us with a very substantial deficit.

You say, to just use your phrase, that the gaps occurred on a grand scale here, and brought about a "gigantic budget deficit."

Now, I am not saying that the tax package by itself created the deficit. I am saying that the net result of our spending patterns and our revenue raising patterns left us with this very substantial deficit, and that it has continued on at somewhat lower levels, depending upon how one agrees as to the accounting that has been done, but we have had very substantial deficits now, year-by-year, through the 1980's.

Is that a fair statement?

Mr. TAYLOR. Yes, sir. And I would emphasize that pinpointing the tax cut as the source, as you mentioned, is not the way to think about it, but to focus both on the spending and the tax side as the two edges of this deficit sword.

The CHAIRMAN. Yes. Well, that is exactly what I want to do.

Now, if we take the spending side and look back in time—and David Stockman has written about it in his book—that for good or ill we ended up deciding as a National Government that we had reached an irreducible minimum on the spending side, the revenue flows were substantially less than the level of spending. That left us with this large structural deficit.

That is not assigning more blame to one side—the revenue or the spending side—than the other; but to simply say, that was just the hard, cold, bottom-line fact, if you looked back through the 1980's.

Now, it would seem to me that just sheer logic would say that, if you find you cannot squeeze the spending down any lower, even if you should, even if people say they want to, if we do not manage to get it done, that at some point you have to face the problem of the shortfall in the revenue to cover the spending.

Normally, I think what logic would say is that, if you cannot get the spending any lower, it just will not come down much more, then somehow you have got to boost the revenue and get it up higher.

Maybe you can do it with growth, maybe it takes higher taxes, whatever it takes, some way or another, you have got to get your revenues up so you pay your bills. Countries, companies, individuals, and so forth none can live with these shortfalls indefinitely.

If you run them indefinitely as a national economic system, you start to get all kinds of worrisome side effects. You can get trade deficits, for example. And you trace the relationship of a structural Federal budget deficit right to a trade deficit. You make a very compelling argument that these things are interrelated, and you are not bashful about saying that both problems worry you.

Mr. TAYLOR. Absolutely.

The CHAIRMAN. I think everything I have said would be a fair statement so far; would it not?

Mr. TAYLOR. Yes, sir. There is a bit of a hypothetical in the way you characterize it, which makes it difficult for me to focus on one side or the other. The hypothetical being, if we are at a point we cannot possibly reduce spending——

The CHAIRMAN. Well, that is why I am going backward in time, because you know there is always a debate about looking forward——

Mr. TAYLOR. That is the difficult part of it——

The CHAIRMAN [continuing]. But the cold fact of the matter is, you are an academic person, and how to take factual information that is behind us and, whether we like it or not, you can pick it up and you can look at it, and you can get a pretty good feel as to what happened—not what will happen, what did happen.

And what did happen is that we found that we were not able to squeeze spending below those levels. That is why our cumulative national deficit has gone from roughly a trillion to $2½ trillion over the better part of the decade of the 1980's, because we got caught in this structural imbalance and we did not find a way to reconcile it on either side. We could not press the spending down, and we could not push the revenues up, and there we are.

Now, you made a very interesting point earlier in the colloquy, I think, with Senator Mack, and Senator Sarbanes partly as well. That is, how do you decide what is the base-line from which you work, as to what should be sort of the tax point from which you start? How much do you take out in the form of taxes?

I drew from what you were saying the notion that if you do not need to do any public spending, if the Government did not have to spend a dime or prepare for the future, presumably you would not have to have any taxes at all. You could have a zero tax rate, because it would not be necessary.

But if the Government has a whole pattern of spending that it has to carry out, everything from defense to getting graduate students through college and other kinds of things, we add up the bills and then that presumably is the amount of revenue that, by one means or another, the Government is going to have to raise if it is going to pay its bills and avoid all of these other worrisome consequences.

Now, it seems to me that, if that is the basic logic and that is the basic premise, that if we find that we have established a block of Government spending or Government investment or Government consumption, whatever you want to call it, that is going to go on year-by-year, somewhat higher, somewhat lower, whatever—that in effect, if we cannot squeeze it down below whatever that irreducible minimum is, that somehow or another we have got to cough up the money to pay for it.

Now, maybe we can find a way to make the system produce more, maybe we cannot. Maybe we just have to draw off more tax revenue in order to just pay the public's bills.

Now, is there any other way out of this thing? I mean, isn't that sort of the inescapable logic? I mean, take away ideology—because we could be talking about whether we were spending 3 percent of GNP, 10 percent of GNP, 12 percent of GNP—aren't these the essential relationships that have to be synchronized, if we are going to have, roughly, more of an equilibrium as we go through time, rather than just a more chaotic situation?

Mr. TAYLOR. Yes, sir. I would agree. I would only add, as a modest amendment that, while I think the goal of choosing what the appropriate level of Government spending is, and looking at a cost-benefit analysis of each of our programs, is the best way to view public policy, in practice, as you know, it turns out to be much more complicated than that.

In that environment, the ideal situation where we focus on this as what the ideal for Government spending is, I think is problematic.

The second amendment would be that, in a way, focusing entirely on the optimal level of Government spending, and looking for the tax revenue that matches that, misses what economists refer to as the disincentives associated with the taxes. I think those have to be considered along with the positive aspects of the Government spending.

There are sort of both sides of this balancing. There is the revenue being raised in order to finance the Government spending which we think is appropriate, but that actually has some disincentives in the economy, which we must face.

The CHAIRMAN. No question about it. But if we find ourselves in a situation where we have a pattern of structural deficits, that whatever the levels of spending and receipts, the spending is running enough above the receipts that we are left each year with a very significant deficit and basically at all levels of unemployment—in other words, if the economy is stronger we still get them; if the economy is weaker, we are still getting the large deficits—if they are rolling up at anywhere like 100, 125, 150, 200, some people say that if you throw out the social security surplus raid that comes over in the unified budget that the deficits are still running on an actual general government expenditure base of about $250 billion a year—if they keep running in excess of, say, at a minimum, $100 billion a year, year after year after year, doesn't that suggest to you that there is something fundamentally out of line between the relationship of spending on the one side, and revenue on the other?

And doesn't it finally start to lead you, even if you are a person who wants lower spending, if you find that you are not accomplishing lower spending and you are running up the bills, but you are not paying the bills because you do not want to actually have to go out and go through the pain of raising the revenue and so you keep adding on these $100 billion-plus deficits year after year—is that a strategy that can go on indefinitely?

I mean, is that a workable long-term strategy that we can just sort of now live with and not find that it boomerangs and creates major problems down the road?

Mr. TAYLOR. No, I do not think that is a good strategy. I would consider it a bad job, if that is what we are delivering as advisors or as public servants, generally, and I would be very concerned about that.

The only thing else I can say on that is, if we are talking about for 100 years, hopefully the $100 billion will become small relative to the growing economy. But that is just a minor point, that the $100 billion will look small then.

The CHAIRMAN. Well, of course you have got to get to the 100 years.

Mr. TAYLOR. Yes.

The CHAIRMAN. I mean, sometimes you get tripped up.

Mr. TAYLOR. Yes.

The CHAIRMAN. Now, I want to ask you a very direct question.

If those basic relationships are right, suppose you get in here and you take your look at it, and you find, even though you may not agree with it, that we are not able to suppress the spending as much as we would like to, we just cannot drive it down. Suppose that David Stockman's thesis is right, that we have gotten down kind of close to an irreducible minimum in terms of Government spending, and, whether we like it or not other things keep barging in, like the savings and loan problem and so forth, over and beyond just the normal activities—and we still have this structural shortfall, spending above the level of revenue. In theory you would like to have less of a tax burden because you get a more efficient economy the lower the level of Government take-out through taxes, but suppose we are stuck with that kind of a situation, and you have got that structural imbalance, and it is running year after year, working off the logic we have just been discussing, do you think you have got the personal strength and the courage to be able to say, even in a closed meeting, to the President or anybody else:

Look, I do not want to see more revenues any more than you do. I read your lips, we all read your lips, but the fact of the matter is, we have got an imbalance here. And if we cannot get the spending down, we have got to think about how we get the revenue into a closer match, because that is the way the basic economic realities confine us.

Do you have the strength to say that, if that is the picture?

Mr. TAYLOR. I would have the strength to recommend that we reduce the budget deficit. If the hypothetical occurs, which I really cannot completely buy into, I'm sorry, the hypothetical of no possibility of slowing the growth of spending—if that hypothetical arises, then the advice as an economist, my advice as an economist, is to focus on the deficit.

But it is a hypothetical, Senator, which I honestly feel uncomfortable dealing with at this point, because we are now negotiating. There is a negotiation and useful discussion, I understand. Much progress is being made, which tries to have all options on the table, all possibilities on the table. And for me to sort of think in terms of the hypothetical of, if one part of that is fixed, what are we going to do, is something which I find very difficult to do.

The CHAIRMAN. Well, I understand. But, you know, this is the big leagues, and you are just stepping into the big leagues, and you are a big league thinker. You know, the long list of articles that you have done, combined with the fact that you have written textbooks and that you really think about these relationships, many of us find very refreshing. Because we think that, if you have got basic, fundamental constraints and realities to have to deal with, somebody that understands that and has enough gumption to say it, even if somebody else does not want to hear it, is a very helpful part of Government.

Mr. TAYLOR. Yes, sir.

The CHAIRMAN. We have a lousy record over the last several years in dealing with fiscal deficits. You are alarmed about it. You have written textbooks about it, because you are alarmed about it. I mean, you have set off the alarm bells. I happen to agree with what you are saying. I think the alarm bells need to be sounded, and you have sounded them.

What often happens, however, is that people come into Government with a nice, clean kind of understanding of economic models and the logic and so forth, and you come in, and there are the politics, and there are campaign promises, and you know there is all the hubris and whether somebody calls something "voodoo economics," and all of this stuff that sort of gets into the environment. What tends to happen, even with very smart, well intentioned people, is that they start to lose their voice, or they lose their ability to be able to say the things that need to be heard and considered, even if people do not want to hear them.

I am not trying to squeeze you into a position. That is why I said at the outset, I am not here to have a philosophic debate. But I would be powerfully disappointed if somebody has to say something that other people do not like to hear that is in line with everything you have presented as an academician, and you didn't say it. Then, I would think, the whole effort sort of collapses.

Mr. TAYLOR. I agree with you 100 percent, Senator. If I cannot speak my own mind, and give my own advice, I should not be here. I intend to be objective, and to give the best advice I can.

My textbook is representative of my views. That is what I teach to undergraduates. I will stand by those views in giving advice in general. Thank you.

The CHAIRMAN. I realize that there is a policy debate going on; there was a campaign promise made on no new taxes that the President feels very strongly about. I am on the Budget Committee and we have been through that whole thing. I am also on the Finance Committee, we were through it there.

I do not ask this question in that immediate context. I am not trying to box you into that and get you into hot water. What I want to understand, though, is, do you have enough intellectual integrity that if the time comes where you feel that the structural deficits are a severe enough problem, and as much as we might like to get it on the spending side, if we cannot close it there and we in fact need some additional amount of revenue in order to make the economic models that we are familiar with work properly—that you have got the strength to say that, and will say that.

I do not presume that that will be tomorrow, in 6 months, or 1½ years. All I want to know is that you are the kind of a person who, if you really believe that that is the case, will not lose your voice and lose your ability to say it, even if it means that somebody says, "Who let that guy in here?" and you have to pack your bags and go back to Stanford.

Mr. TAYLOR. Yes, sir. If I believe that is the case, that is what I will recommend. If I believe—any issue which I believe on the basis of economic analysis, I would certainly recommend it, yes, sir.

The CHAIRMAN. And I take it that you are willing to really address yourself to that fundamental issue, that you see that as a key issue, the question of structural fiscal deficits and their relationship to structural trade deficits, and that that is up very high on your list of key issues that have to be dealt with and resolved by one strategy or another. Is that correct?

Mr. TAYLOR. Yes, sir. The budget deficit is a very important priority for me.

The CHAIRMAN. Do you put it first? Where do you put it?

Mr. TAYLOR. It is first, in the sense that it is at the heart of the savings investment imbalance, which is the ultimate problem, that we are saving too little, and that is part of the reason we are saving. So it is first, in the sense that it is the most immediate thing we can do to address the savings investment balance trade deficit in the U.S. economy. In that sense, it is the highest priority for me, yes.

The CHAIRMAN. And you take them as a cluster? Am I understanding you to say that, because you cannot isolate the fiscal deficit alone—you start with that, but that relates to the trade deficit, and that relates to the savings rate, and the investment rate in the country——

Mr. TAYLOR. Yes.

The CHAIRMAN [continuing]. And you really have to take, say, at least those four as a cluster?

Mr. TAYLOR. It is a whole package. It is a whole package. And by putting high priority on the Federal dissaving, I would not want to deemphasize the low private savings rate. I think we need to think about that, and we need to work on it. We need to study to what extent it is demographic.

There has been, actually, a refreshing increase in the private savings rate over the last 18 months or so. I am very interested in whether that is a trend in a different direction, or whether it is a short-run effect. It is something we are studying very carefully. But there are some positive signs on the saving.

Another positive sign, which I do not think is in the numbers yet, but will be coming in in a matter of years rather than quarters, is the demographic changes in the population. More of the baby boom generation going into age groups where there is more savings being done will increase our savings rate.

I am a baby boomer. As I move into an older age group, I presumably will save more, and other people in my generation will, too, and that will increase our savings rate.

The CHAIRMAN. Well, when you sit on the Finance Committee, and you start to look at the medical bills that are piling up of an aging population, of which you and I are a part, as our hairs gray, and others join us——

Mr. TAYLOR. Yes.

The CHAIRMAN [continuing]. You know, there are things that cut through those demographics that add to the cost, both public and private.

Mr. TAYLOR. Yes.

The CHAIRMAN. Are you concerned about the degree to which the leverage buy-out movement in the last few years is really changing the composition of private company balance sheets, where we are seeing, I think, a rather steady exchange of equity for debt, and the leveraging, the sort of de-equity move——

Mr. TAYLOR. Yes.

The CHAIRMAN. Does that concern you?

Mr. TAYLOR. Yes, it does. The extent to which debt is replacing equity for tax reasons, or for reasons unrelated to efficient financing of corporations, does concern me.

At this point, I do not believe the debt-equity ratios have risen to the point where we are in any danger. We have had debt-equity

ratios of this magnitude before in the U.S. economy. But to the extent that those are rising because of tax effects, which I believe is part of it, the relatively high rate of financing of equity compared to debt finance, I think that is a problem, yes.

The CHAIRMAN. Is part of it, too, the shortfall in savings? In other words, if you look, for example, at the new issue and secondary issue markets, particularly since the crash, there is plenty of evidence to show that, while we have a somewhat anemic savings rate, even with the improvement of the last 18 months, that fewer people are willing to take and put their savings into the kind of equity that we have often seen more investment in in the past: New company starts, secondary stock issues, and so forth.

Have you studied that? Is that a concern to you?

Mr. TAYLOR. It is certainly of some concern. Curiously, the effect of the leverage buy-out actions actually seems to have increased savings a little bit. It is for just a technical quirk, the extra capital gains that individuals receive as a result of these leveraged buy-outs has an effect on income. It actually seems to have a slight effect on saving.

That goes in the opposite direction that you are concerned with, and I think it is more of a statistical anomaly. But I am very much concerned about keeping the cost of capital for new businesses as low as possible, and encouraging new business in the United States. That has been the source of strength in the U.S. economy, and why we are still the most productive economy in the world.

We need to be concerned about that.

The CHAIRMAN. But don't we have just about the highest real interest rates right now? Isn't the cost of capital in the United States about as high as anywhere in the major industrial world?

Mr. TAYLOR. The cost of capital is much higher than in Japan. The real interest rates in the United States are still high. They have been higher in the 1980's and the 1960's and the 1970's. And that is a problem. That is definitely a problem.

The CHAIRMAN. And is that something that you will be addressing yourself to in this new capacity? Will you be looking at that as a significant subpart of this larger puzzle?

Mr. TAYLOR. Yes, sir. It is part of the savings investment imbalance, which I intend to deal with.

The CHAIRMAN. How about just the market mechanisms themselves? We have got the Brady commission report and the aftermath of the market crash. Have you spent much time in your academic background, thinking about how capital markets work and about the global market that the Brady commission and others say is now the new fact of life? Are you conversant with that?

Mr. TAYLOR. Yes. One of the things that I have focused on are the international linkages between financial markets, and I have traced out the implications of that for economic behavior, macroeconomic behavior, the business cycle. I think it is a concern which those interested in financial markets need to direct themselves to, the linkage between equity markets, bond markets in different countries, basically 24-hour trading where there is one global market, whether differences in regulations among the different countries cause capital to flow from one country to another for arbitrary reasons.

We saw in the market break in 1987 that there was similar movement in many stock markets around the world. These markets are certainly linked, and it is something that we should be thinking about.

The CHAIRMAN. You know, I am not asking you to have been a person who could somehow see the future, when no one can see the future; but did it surprise and shock you when the stock market, the Dow Jones average, went down 508 points in a single day? Had you imagined at the time, as nearly as you can recall, that we could have had that kind of a severe market break, given the overall economic picture at the time?

Mr. TAYLOR. It surprised me very much, that magnitude of a change in a matter of hours. It was certainly a great surprise. My reaction to it was to come back and see what the net effect of that decline would be on the economy, the reduction in people's wealth, how much of an effect would it have. My calculation at the time was that it would probably have a small effect on the aggregate economy, no recession but just a slow-down. I think that has turned out to be OK. In fact, it has been even better than we predicted. It has not had that big an effect.

But that does not mean we should not be concerned about it, and the efforts or circuit breakers and other means to prevent this in the future I think deserve more consideration and reassessment.

The CHAIRMAN. Do you feel that you are versed enough in that area to answer this hypothetical question: If the markets had in fact shut down—and they came very close to shutting down, but they did not shut down, and they stayed open—had there been a kind of freeze or a kind of paralysis where the markets in fact had been forced to close, this would have been on the Tuesday—that was the real test, around noon time on Tuesday—just thinking about it, in terms of your sense for how markets work, if we had actually had the New York Stock Exchange and the Chicago Exchange actually shutting down, and the ripple effect that that might have caused, with the psychological reactions and people not being able to make payments and handle clearances and so forth, would that likely have given us a far more severe follow-on effect, if we had actually had the unthinkable happen and the markets actually close, rather than manage to have them continue?

Mr. TAYLOR. I believe so. My assessment is that that would have made things worse, and it was a wise decision to keep those markets open. Yes, sir.

The CHAIRMAN. If I may, I want to just give you a personal observation on that, in the spirit of the kind of serious discussion that we are having here today. That is, on that particular day, I happen to have been the chairman of the Securities Subcommittee here on this committee at that time, and obviously was following it very closely.

Around noontime, 12:30, thereabouts, on that day, I spoke in back-to-back conversations, first with John Phelan at the New York Stock Exchange, and then with Leo Melamed at the Chicago Mercantile Exchanges. They were in the middle of this maelstrom of unprecedented dimension.

I do not know if you have ever been in a situation where the tension and the anxiety is so great that your voice changes—have you ever had that happen?

Mr. TAYLOR. I lose my voice occasionally from talking too much, but——

The CHAIRMAN. Well, I have had it happen to me, I remember. I will not bore you with the details. But all of a sudden, a situation was so horrendous that I heard this voice speaking and it was my own, and it was an octave higher, because it just—that can happen.

These two gentlemen, whose voices I was quite familiar with, I heard at least an octave higher. It was just one signal as to how extreme the situation was.

As nearly as I could tell at the time and since, we came within a literal eyelash of having the market system shut down. I cannot imagine a narrower escape. At the time prior to the market coming back that afternoon, there was a real question in the minds of the market central players whether we would get through that period.

It causes me to say afterward that I am very uneasy about the fact that we came that close. The fact that we came that close and survived is some consolation, but I think if you're a thinking person, you say to yourself, "I do not want to live with those kinds of margins of safety, or anything close to it, when the stakes are so high."

The risks of a failure, when you succeed by that much, presumably you can also fail by the same amount or even more.

In any case, will that be an area that you will be looking at, as well? That will not be just a Treasury Department issue?

Mr. TAYLOR. The Treasury Department has the primary responsibility for those issues, and there is a continuation of the working group on the financial markets which followed the Brady commission report. That work will be proceeding.

At this point, that is something that is down the line. I certainly hope to be very much involved in that, because that working group will consider such things as the global implications of financial market integration, the market break issue, circuit breakers, and other issues associated with this. So that is the primary input.

There is also, of course—it is very important because of the crisis situation you just described to be always prepared for these kinds of things. I hope very much that we think in terms of being prepared for the worst, and making sure that we do the best we can when anything horrible like that occurs again.

So I think there are two reasons to be very conscious of it; first, in case something happens again, and second, just to think about what is the best way to reform the system for the longer term.

The CHAIRMAN. I have one other question for you today, and I appreciate your answers and the time you are spending at them.

This is a hypothetical; I am not asking you to say this is the case, I just want to understand your view of how the economic system would likely function under these conditions.

Let's say we do not get the Federal budget deficits under control. We intend to and hope to, but let's just say that that does not happen, and the trade deficits stay large, we skate on out into the 1990's, we pass this trillion dollar debtor nation mark that we are scheduled to hit about 1992, and we keep piling up the internation-

al debt. For one reason or another, we just cannot get a strategy in place that sort of gives us a different kind of a balance.

Suppose we run that debt up, $1½ trillion, $1¾ trillion. We are all of a mind to say that we do not want to get out and test those outer limits. But when you talk about the cost to the next generation, or even to this generation, what is it that we are in jeopardy of seeing dissipated or lost or foregone, if we do not manage to get a successful long-term strategy in place?

If we continue to run big budget deficits, big trade deficits, find ourselves in that posture, to the man and woman on the street, what does that mean? What are the base-line consequences for mothers and fathers and young people starting out and older people, as they think about what this could potentially mean?

In other words, what are the stakes here? What could happen, even in terms of economic theory, if we continue to let imbalances like that grow? How does it really come back and hurt us?

Mr. TAYLOR. The way it will come back and hurt us is, unfortunately, very gradual, in sort of a slow squeeze. We will see that, over time, we will be able to consume less because as a nation we are earning less, we are paying more of our earnings abroad. So gradually, over time, we will be consuming less, and our standard of living will be reduced.

The more years you go out, the more that compound growth rate accumulates, and it becomes a substantial effect. But basically, the implication of that is, our standard of living is lower, because we have saved less and because we are paying more abroad as individuals.

The person who saves more now is going to be able to consume later. The person who saves less now is going to be able to consume less. As with persons, with countries. That is the main danger.

In fact, in my view, the fact that it is such a gradual thing, it is sort of unnoticeable, you do not have these crises—you do not see the crises occurring, and that is why it is such a difficult problem to deal with.

I am optimistic. Maybe these savings rate increases will make a difference, the demographics. The demographics are actually going in the opposite direction in Japan. I am optimistic, but I am very concerned that we are not going to make it, and that our standard of living will not be as great 20 years from now as it would otherwise be, if we do not invest in the future.

The CHAIRMAN. May I introduce one other point to that? That is, my own sense in watching how the economy works, we have got some major economic dividing lines: There is a lot of data that shows that people at the high end of the economic spectrum have been doing pretty well in the last few years; there are a lot of people who are sort of trapped at the low end where it is very hard to make progress, partly because the technical requirements are rising, and so forth; and there is a fair amount of the middle class that seems to have stalled out too, some are moving up the income ladder, a lot are staying even, some are sliding backward.

You start to see new patterns. When we came through graduate school, it was much easier to pay our way and get through, and not come out with a huge debt at the other end than is true for stu-

dents coming through today. I see that pattern all through my State.

So it is much harder to get an economic toe-hold, even if you are a person coming out with an undergraduate degree or a graduate degree.

Unfortunately, 24 percent of all of our young people in this country are not even making it through high school, so we have got this huge investment differential in education just at the basic high school level, as compared say with Japan with their 2 percent drop-out rate.

But when you look at the number of Ph.D.'s that we are graduating, say, in California, which is our most vibrant place to crank out people with advanced education in the country, the largest State by far, I am told by the people who are involved that we are getting the tiniest trickle of people coming through with Ph.D. degrees in critical fields who can go back and even hope to teach somebody else so we can grow the next crop of people to come along and do these things.

I see enormous capital investment shortfalls. It is part of the savings rate problem, in my view, in a different form. A huge problem, I think very threatening for the long term. We do not even talk about it.

Mr. TAYLOR. Unfortunately, we do not talk about it enough. I agree.

The CHAIRMAN. It is not even in the national debate. You and I talk of it to a relatively empty room here, but we do not seem to be able to get that issue out there. Now, of course, that relates partly to our spending rates, whether it is public spending, private spending—you know you are not going to get people through a Ph.D. program unless some money is spent for professors, and facilities, and tuition, and books, and room and board, and so forth.

So will you be able to put these kinds of issues on the table? I mean, it seems to me that one of the values coming out of the higher education area is that you have some sense for what the shortfall in that area is.

Can you talk to the President about these things?

Mr. TAYLOR. I have an enormous interest in education. Aside from the fact that I am a professor, generally I think it is one of the keys to keeping America strong. The area which I would focus on now as the greatest concern is related to the 24 percent that you mentioned, that is really not getting even the basic minimum of education.

We have an enormous disparity among elementary schools now, good schools and bad schools. I think we are really running into a problem of having a major component of our labor force undertrained. Already, we are seeing that, and it is making us less productive.

I would like to find ways to focus on the elementary and secondary education, improving on that. I have thought about it a lot. I have actually been involved in the local public schools. I have observed first-hand the job the Japanese do. My children actually went to a Japanese school when we lived there for a while. I am very interested in it.

What I have observed, Senator, is that many of the things that we can do to improve elementary education in school are not directly related to spending more money. It is situations where somehow the class size is a factor, but it is not the only factor. It is a situation where——

The CHAIRMAN. Well, it is good nutrition, the kid needs glasses and does not have glasses, it is that there is not a home situation that is conducive to studying and reading, and being able to get to and from school safely—you are exactly right.

But all of those things have a cost. To get from where we are to where we want to be, we cannot wave a wand, we cannot do it with a national cheerleader.

In other words, those structural subproblems of health, nutrition, jobs, housing, neighborhood safety, do require resources, if you are going to move from where you are to where you want to be.

I have seen a parade of theorists come through this town in the last 8 years who somehow think there is a way to do this, without resources. So we have not made a hell of a lot of progress in a lot of those areas, because nobody has found a way to do it without the resources.

Jack Kemp, our good friend, who has the jurisdiction for half of this committee's work, is going to see if he can do it in the HUD Department without resources. I think already he is finding it very difficult.

That is not to say that turning on the money faucet is the answer, because you can blow money on things that do not improve the situation either. But I would hope that somebody who is practical and who understands cross-connecting links, can put some of these issues on the table.

Is there an economist in the country today who is talking about that kind of economics, the economics of an educated workforce, the economics of a savings rate that really drives a faster research and productivity improvement speed in the country, that looks at the problem of a debtor nation overhang?

Is there somebody who is putting together the new economics, the economics of how do you make progress in a global economy, and get off some of these trend lines? And if so, who is that person?

Mr. TAYLOR. The economists who focus on the educational role, the role of education in improving productivity, are mainly labor economists. Gary Becker at the University of Chicago is probably——

The CHAIRMAN. Well, who adds it all up? Do you have to go and get somebody who has got a little piece of it? Is there somebody who is capable of putting all of the pieces in one framework and saying:

> Look, the economic model of 1989, the United States having gone through this epic change post-World War II, in the world economy and in global markets—you now have to think in terms of this as your economic package.

So we do not race off to find somebody who is sitting at some university who happens to be the ace on labor economics, but somebody who can put the puzzle together. Because that is what the President needs. That is what we need. We need somebody who can put all of the relevant strategic pieces—I am not talking about fine

micropieces, I am talking about the major elements of the puzzle—into one coherent way of thinking about where we are.

I am trying very hard to figure out how to get that discussion started, just started.

Mr. TAYLOR. It is a very important discussion. I actually cannot think of someone who has actually traced out such a big strategy, a big sort of new economics that you seem to be focusing on, putting together the pieces. But I agree with you 100 percent, it is something which would be useful for delivering some results in the savings investment growth, international trade.

But it is such an immense problem at this point, perhaps that is why I cannot think of someone off the top of my head for that——

The CHAIRMAN. Well, why don't you take a whack at it?

Mr. TAYLOR. Yes, sir.

The CHAIRMAN. Because I think you are smart enough to do that. We need somebody who can take this, who understands the changes and the pieces, to start to think in terms of: What is the nature of the new puzzle now? That is my premise, that the puzzle has changed.

The textbooks I studied at the University of Michigan and the Harvard Business School in Economics frankly are not worth much today, in terms of what I see happening. I have got CEOs coming in every day, financial market people coming in every day, consumers, international visitors coming in every day. Ninety percent of what I am hearing and seeing and feeling and reading about, and putting together in my own analysis, does not neatly fit all of the economics training that I got from some of the best economics professors along the way—not all that long ago.

So it seems to me that we need somehow to recast our thinking, without being revolutionaries or ideologues or anything of the sort, but to try to capture this blend of new realities that is really now the global situation, so we can start to think about strategies, you know.

How do we get some of these key trend lines within this larger puzzle corrected and working in a direction that does not steal the future from our kids, or even from ourselves or from our parents?

I just finish by saying, I do not think we are now proceeding in a way where we are going to hand-off to our children an opportunity as good as the one that was handed to us. Now, there are a lot of reasons for that, and it is the way the world has changed, the work ethics, and what we spend our money on—an awful lot of dough has been spent on things that do not really have much of a carry-forward in terms of value or yield.

But it seems to me that, if we are going to change that and let our kids have at least as good a start in the game as was handed to us, then we have got to crank up our performance substantially. That means we have to understand the problem first, but then we have got to really work to get some strategies in place so that we really keep the same faith with them that was our bond going backward to the last generation.

I hope we can work together on that.

Mr. TAYLOR. I would be happy to, Senator.

The CHAIRMAN. Thank you very much.

Let me just announce that Senator Cranston has voted "Aye" by proxy on the four nominations, and the record will remain open for any others that may not have been recorded here.

I thank you for your patience and for your answers, and wish you well.

Mr. TAYLOR. Thank you, Mr. Chairman.

The CHAIRMAN. The committee stands in recess.

[Whereupon, at 12:23 p.m., the committee adjourned.]

STATEMENT FOR COMPLETION BY PRESIDENTIAL NOMINEES

Name: TAYLOR (LAST) JOHN (FIRST) BRIAN (OTHER)

Position to which nominated: MEMBER, COUNCIL OF ECONOMIC ADVISERS Date of nomination: MAY 1, 1989

Date of birth: 8 (DAY) 12 (MONTH) 46 (YEAR) Place of birth: YONKERS, NEW YORK

Marital status: MARRIED Full name of spouse: RAYE ALLYN TAYLOR

Name and ages of children: JENNIFER LYNN TAYLOR - 11

JOHN ANDREW TAYLOR - 8

Education:

Institution	Dates attended	Degrees received	Dates of degrees
PRINCETON UNIVERSITY	9/64-6/68	AB	1968
STANFORD UNIVERSITY	9/68-3/73	Ph.D.	1973

Honors and awards: List below all scholarships, fellowships, honorary degrees, military medals, honorary society memberships, and any other special recognitions for outstanding service or achievement.

WOLF BALLEISEN PRIZE FOR BEST SENIOR THESIS IN ECONOMICS - PRINCETON UNIVERSITY 1968

SUMMA CUM LAUDE - PRINCETON UNIVERSITY 1968

DISTINGUISHED NAVAL GRADUATE - OFFICER CANDIDATE SCHOOL - NEWPORT, RHODE ISLAND, 1970

ECONOMETRICS SOCIETY FELLOW - 1985

GUGGENHEIM FELLOW, 1983-84

Memberships: List below all memberships and offices held in professional, fraternal, business, scholarly, civic, charitable and other organizations.

Organization	Office held (if any)	Dates
AMERICAN ECONOMIC ASSN		1974-1989
ECONOMETRIC SOCIETY		1974-1989
AMERICAN STATISTICAL ASSN		1974-1989

Employment record: List below all positions held since college, including the title or description of job, name of employment, location of work, and dates of inclusive employment.

9/84-PRESENT - PROFESSOR, STANFORD UNIV, STANFORD, CA

3/85-11/88 - CO-EDITOR, AMERICAN ECON REVIEW, PRINCETON, NJ

3/87 - 6/87 - VISITING SCHOLAR, BANK OF JAPAN, TOKYO, JAPAN

9/80-8/84 - PROFESSOR, PRINCETON UNIVERSITY, PRINCETON, NJ

1/80 - 7/80 - VISITING PROFESSOR, YALE UNIV, NEW HAVEN, CT

8/86 - 8/86 - VISITING SCHOLAR, BANK OF FINLAND, HELSINKI

6/80 - PRESENT - RESEARCH ASSOCIATE, NATL BUREAU, ECON RESEARCH

6/78 - 8/84 - RES. ADVISER, FED RESERVE BANK OF PHILADELPHIA

3/78 - 6/81 - ECONOMETRIC CONSULTANT, TOWNSEND-GREENSPAN, NYC

1/73 - 8/80 - PROFESSOR, COLUMBIA UNIV, NYC

8/76 - 8/77 - SR STAFF ECON, COULCIL OF ECONOMIC ADVISERS,WASH,D

5/69 - 10/69 - ENSIGN/ANALYST, ASW SYS PROJ OFC, U.S. NAVY

Government experience. List any experience in or direct association with Federal, State, or local governments, including any advisory, consultative, honorary or other part-time service or positions.

U.S. NAVY, OFFICER CANDIDATE, ENSIGN, LT (j.g.)

COUNCIL OF ECONOMIC ADVISERS, SENIOR STAFF ECONOMIST

RESEARCH ADVISER, FEDERAL RESERVE BANK OF PHILADELPHIA

CONSULTANT, CONGRESSIONAL BUDGET OFFICE

CONSULTANT, FEDERAL RESERVE BOARD

CHAIRMAN, ADVISORY PANEL, PALO ALTO SCHOOL BOARD

MEMBER, ADVISORY PANEL, NATIONAL SCIENCE FOUNDATION

Published writings: List the titles, publishers and dates of books, articles, reports or other published materials you have written.

(SEE ATTACHED LIST)

Political affiliations and activities: List all memberships and offices held in and services rendered to all political parties or election committees during the last 10 years.

NONE

Political contributions: Itemize all political contributions of $500 or more to any individual, campaign organization, political party, political action committee or similar entity during the last eight years and identify the specific amounts, dates, and names of the recipients.

EDWARD ZSCHAU FOR U.S. SENATE, 1986, $500.00

Qualifications: State fully your qualifications to serve in the position to which you have been named.
(attach sheet)

Future employment relationships:

1. Indicate whether you will sever all connections with your present employer, business firm, association or organization if you are confirmed by the Senate.

I WILL BE ON LEAVE WITHOUT PAY OR OTHER BENEFITS, FROM STANFORD UNIV. I WILL NOT RECEIVE ANY PAY FROM THE NATL BUREAU OF ECON RESEARCH. I WILL RECEIVE BOOK ROYALITIES FOR W.W. NORTON. I WILL ASSIGN A SUBSTITUTE PRINCIPAL INVESTIGER FOR MY NATIONAL SCIENCE FOUNDATION GRANT.

2. As far as can be foreseen, state whether you have any plans after completing government service to resume employment, affiliation or practice with your previous employer, business firm, association or organization.

I PLAN TO RESUME EMPLOYMENT AFTER MY LEAVE FROM STANFORD.

3. Has anybody made you a commitment to a job after you leave government?

MY LEAVE FROM STANFORD PERMITS ME TO RETURN.

4. Do you expect to serve the full term for which you have been appointed?

THERE IS NO SET TERM FOR A CEA MEMBER.

Potential conflicts of interest:

1. Describe any financial arrangements or deferred compensation agreements or other continuing dealings with business associates, clients or customers who will be affected by policies which you will influence in the position to which you have been nominated.

NONE.

2. List any investments, obligations, liabilities, or other relationships which might involve potential conflicts of interest with the position to which you have been nominated.

NONE. I AM IN THE PROCESS OF SETTING UP A QUALIFIED DIVERSIFIED TRUST FOR THE MARKETABLE SECURITIES LISTED IN THE NET WORTH STATEMENT, AND MY WIFE IS DISPOSING OF HER HOLDINGS OF NON-MARKETABLE SECURITIES LISTED IN THE NET WORTH STATEMENT.

3. Describe any business relationship, dealing or financial transaction (other than tax-paying) which you have had during the last 10 years with the Federal Government, whether for yourself, on behalf of a client, or acting as an agent, that might in any way constitute or result in a possible conflict of interest with the position to which you have been nominated.

NONE.

4. List any lobbying activity during the past 10 years in which you have engaged for the purpose of directly or indirectly influencing the passage, defeat or modification of any legislation at the national level of government or affecting the administration and execution of national law or public policy.

NONE.

5. Explain how you will resolve any potential conflict of interest that may be disclosed by your responses to the above items.

THE DISPOSAL OF MY WIFE'S NONMARKETABLE SHARES AND THE QUALIFIED DIVERSIFIED TRUST DESCRIBED IN QUESTION 2, ABOVE.

Civil, criminal and investigatory actions:

1. Give the full details of any civil or criminal proceeding in which you were a defendant or any inquiry or investigation by a Federal, State, or local agency in which you were the subject of the inquiry or investigation.

NONE.

2. Give the full details of any proceeding, inquiry or investigation by any professional association including any bar association in which you were the subject of the proceeding, inquiry or investigation.

NONE.

Personal Statement of Qualifications

President Bush has nominated me to be a Member of the Council of Economic Advisers (CEA). I feel that my training in economics and my experience as an economist in universities, research institutes, government and business, qualifies me for this position.

I received a bachelors degree in economics summa cum laude from Princeton University and a Ph.D. in economics from Stanford University. I have been a tenured full professor at three major universities: Columbia, Princeton, and now Stanford. I have been a member of the faculty of economics in each of these universities, and at Princeton I was also on the faculty of the Woodrow Wilson School of Public and International Affairs. I have been an active research associate at the National Bureau of Economic Research, a member of the Brookings Panel on Economic Activity, and an advisor to the Carnegie-Rochester Conference Series on Public Policy. I have been awarded a series of grants from the National Science Foundation, the Guggenheim Foundation, and the Social Science Research Council. My government service as an economist includes positions as senior staff economist at the CEA, research adviser at the Philadelphia Federal Reserve Bank and consultant to the Federal Reserve Board and the Congressional Budget Office. In 1987 I spent several months as a research economist at the Bank of Japan in Tokyo, and in 1986 I visited the Bank of Finland in the same capacity. For several years I was a consultant to the firm of Townsend-Greenspan in New York City.

My fields of expertise as an economist are macroeconomics, monetary economics and international economics, with a strong emphasis on public policy. These are the areas that I will deal with as a Council Member.

As an economic adviser, my technical skills as an economist must be matched by communication skills. I have published numerous research papers in my areas of expertise and have lectured throughout North America, South America, Europe and Asia on these subjects. I have published a textbook in macroeconomics which is being used at over 250 universities in the U.S. and other countries. I regularly teach economics at both the advanced and elementary levels. Last fall I gave a series of 36 lectures in elementary economics to over 400 students at Stanford and received one of the best teacher ratings ever recorded. For four years I served as co-editor for macroeconomics and international economics at the American Economic Review, the official scholarly journal of the American Economic Association.

I believe my past record shows that I will dedicate myself fully to this position, that I will get the job done and that I will give the best possible advice I am capable of giving.

LIST OF PUBLISHED BOOKS AND ARTICLES

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Books

Macroeconomics: Theory, Performance and Policy (with Robert E. Hall), W.W. Norton, New York, 1986, Second Edition, 1988.

Published Articles

"Asymptotic Properties of Multiperiod Control Rules in the Linear Regression Model," International Economic Review, 15, June 1974.

"Monetary Policy During a Transition to Rational Expectations," Journal of Political Economy, 83, October 1975.

"On a Efficient Two-Step Estimator for Dynamic Simultaneous Equation Models with Autoregressive Errors," (with P.J. Dhrymes), International Economic Review, 17, June 1976.

"Methods of Efficient Parameter Estimation in Control Problems," Annals of Economic and Social Measurement, 4, July 1976.

"Strong Consistency of Least Squares Estimates in Normal Regression," (with T.W. Anderson), Annals of Statistics, 4, July 1976.

"Some Experimental Results on the Statistical Properties of Least Squares Estimates in Control Problems," (with T.W. Anderson), Econometrica, 44, November 1976.

"The Deterrence Controversy: A Reconsideration of the Time Series Evidence,"with P. Passell), in Capital Punishment in the United States, H. Bedau and C. Pierce (eds.), AMS Press 1976.

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John B. Taylor

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"Stabilizing Powers of Monetary Policy under Rational Expectations," (with E.S. Phelps), Journal of Political Economy, 84, February 1977. Reprinted in E.S. Phelps (ed.), Studies in Macroeconomic Theory: Employment and Inflation, Academic Press, 1979.

"The Deterrent Effect of Capital Punishment: Another View," (with P Passell), American Economic Review, 67, June 1977. Reprinted in Thomas D. Cook (ed.), Evaluation Studies Review Annual, Sage Publications, 1978.

"Conditions for Unique Solutions in Stochastic Macroeconomic Models with Rational Expectations," Econometrica, 45, September 1977.

"Econometric Models of Criminal Behavior: A Review," in J. Heinke (ed.) Contributions to Aconomic Analysis Series: Economic Models of Criminal Behavior, North-Holland, 1978.

"Staggered Wage Setting in a Macro Model," American Economic Review, Papers and Proceedings, 69, May 1979.

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"Recent Developments in the Theory of Stabilization Policy" in L. Meyer (ed Stabilization Policy: Lessons from the 1970s and Implications for the 1980s, Working Paper No. 53, Center for the Study of American Business April 1980. Reprinted in Economic Perspectives, An Annual Survey of Economics, Vol. 3, 1984.

"An Inequality for a Sum of Quadratic Forms with Applications to Probability Theory," (with T.W. Anderson), Linear Algebra and its Applications, 1980.

"Economic Theory, Model Size, and Model Purpose," in J. Kmenta and J.B. Ramsey (ed.), Large Scale Macro-Econometric Models, North-Holland, 1981.

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"Stabilization, Accommodation, and Monetary Rules," American Economic Review, Papers and Proceedings, 71, May 1981.

"On the Relation between the Variability of Inflation and the Average Inflation Rate," in K. Brunner and A.H. Meltzer (eds.), The Costs and Consequence of Inflation, Carnegie-Rochester Conference Series on Public Policy, Vol. 15, North-Holland, 1981.

"Macroeconomic Tradeoffs in an International Economy with Rational Expectations," in W. Hildenbrand (ed.), Advances in Economic Theory, Cambridge University Press, 1982.

"Establishing Credibility: A Rational Expectations Viewpoint," American Economic Review, Papers and Proceedings, 72, May 1982.

"Policy Choice and Economic Structure," Occasional Papers, 9, Group of Thirty, New York, 1982.

"The Swedish Investment Funds System as a Stabilization Policy Rule," Brookings Papers on Economic Activity, 1, 1982.

"The Role of Expectations in the Choice of Monetary Policy," in Monetary Policy Issues for the 1980's, Federal Reserve Bank of Kansas City, 1982.

"Rational Expectations and the Invisible Handshake," in J. Tobin (ed.) Macroeconomics, Prices, and Quantities, Brookings Institution, 1983.

"Solution and Maximum Likelihood Estimation of Dynamic Nonlinear Rational Expectations Models," (with R.C. Fair), Econometrica, 51, July 1983.

"Optimal Stabilization Rules in a Stochastic Model of Investment with Gestation Lags" in S. Karlin, T. Amemiya, and L.A. Goodman (eds.), Studies in Econometrics, Time Series, and Multivariate Statistics, Academic Press, 1983.

"Union Wage Settlements During a Disinflation", American Economic Review, 73, December 1983.

"Recent Changes in Macro Policy and Its Effects: Some Time Series Evidence," American Economic Review, Papers and Proceedings, May 1984.

"Rational Expectations Models in Macroeconomics," in K.J. Arrow and S. Honkapohja (eds.) Frontier of Economics, Basil Blackwell, Oxford, 1985.

"What Would Nominal GNP Targetting Do to the Business Cycle?" Carnegie-Rochester Conference Series on Public Policy, Vol. 22, North-Holland, 1985.

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"International Capital Mobility and the Coordination of Monetary Rules," (with Nicholas Carlozzi), in J. Bahdhari (ed.) Exchange Rate Management Under Uncertainty. MIT Press, 1985.

"International Coordination in the Design of Macroeconomic Policy Rules," European Economic Review, 25, 1985.

"Estimation and Solution of Linear Rational Expectations Models Using a Polynomial Matrix Factorization," (with C. Ates Dagli) Journal of Economic Dynamics and Control, 8, 1985.

"New Econometric Approaches to Stabilization Policy in Stochastic Models of Macroeconomic Fluctuations," in Z. Griliches and M. Intriligator (eds.) Handbook of Econometrics, Vol. 3, North-Holland, 1986.

"Improvements in Macroeconomic Stability: The Role of Wages and Prices," in Robert J. Gordon (ed.) The American Business Cycle: Continuity and Change, University of Chicago Press for NBER, 1986.

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"The Role of Contracts in Macroeconomic Performance," in H. Nalbantian (ed.), Incentives, Cooperation and Risk Sharing: Economic and Psychological Perspectives on Employment Contracts, Rowman and Littlefield, Totowa, New Jersey, 1987, pp. 189-201.

"Externalities Associated with Nominal Wage and Price Rigidities," in W. Barnett and K. Singleton (eds.), New Approaches to Monetary Economics, Cambridge University Press, Cambridge, 1987, pp.350-367/

"Involuntary Unemployment," in J. Eatwell, M. Milgate, and P. Newman (eds.), The New Palgrave: A Dictionary of Economic Theory and Doctrine, Stockton Press, New York, 1988.

"The Treatment of Expectations in Large Multicountry Models," in R. Bryant et al. (eds.) Empirical Macroeconomics for Interdependent Economies, Brookings Institution, Washington, 1988, pp.161-182.

"The U.S. Trade Deficit, Saving-Investment Imbalance and Macroeconomic Policy: 1982-87," in Albert E. Burger (ed.) The U.S. Trade Deficit: Causes, Consequences, and Cures, 12th Annual Economic Policy Conference Proceedings: Federal Reserve Bank of St. Louis, Kluwer Academic Publishing, Boston, 1988.

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"Japanese Macroeconomic Policy and the Current Account under Alternative International Monetary Regimes," Monetary and Economic Studies, Bank of Japan, Vol. 6, No. 1, May 1988, pp. 1-36.

"Differences in Economic Fluctuations in Japan, the U.S. and Europe: The Role of Nominal Rigidities," Journal of the Japanese and International Economies, forthcoming 1989.

"Monetary Policy and the Stability of Macroeconomic Relationships," A.W. Phillips Lecture, Journal of Applied Econometrics, forthcoming 1989.

"Policy Analysis with a Multicountry Model in Ralph Bryant, D. Currie, J. Frenkel, P. Masson, and R. Portes (eds.), Macroeconomic Policies in an Interdependent World, International Monetary Fund, forthcoming 1989.

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"Stabilization Policies in a Disequilibrium Growth Model," Proceedings of IEEE Conference on Decision and Control, December 1973.

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"The Determinants of Economic Policy with Rational Expectations," Proceedings of IEEE Conference on Decision and Control, December 1977.

"Comments on Temporal and Sectoral Aggregation of Seasonally Adjusted Time Series," in Arnold Zellner (ed.), Seasonal Analysis of Economic Time Series, U.S. Department of Commerce, 1978.

"'Forward' to Special Issue on Rational Expectations Analysis," Journal of Economic Dynamics and Control, 2 February 1980.

"On the Possibility and Desirability of Stabilization Policy: A Comment," in S. Fischer (ed.), Rational Expectations and Economic Policy, University of Chicago Press, 1980.

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"Comments on 'Labor Market Contracts and Inflation' by D.J.B. Mitchell and L.J. Kimball," in Workers, Jobs, and Inflation, M.N. Baily (ed.), Brookings, 1982.

"Comments on 'Relative Shocks, Relative Price Variability and Inflation,' by Stanley Fischer," Brookings Papers on Economics Activity, 1, 1982

"Comments on 'Wage Rigidity and Unemployment in OECD Countries' by D. Grubb, R. Jackman and R. Layard," European Economic Review, 16, March/April 1983.

"Comments on 'Staggered Contracts and Exchange Rate Policy' by Guillermo Calvo"in J. Frenkel (ed.), Exchange Rates and International Macroeconomics, University of Chicago Press for National Bureau of Economic Research, 1983.

"Comments on 'Equilibrium Theory with Learning and Disparate Expectations: Some Issues and Methods,' by Robert M. Townsend," in R. Frydman and E.S. Phelps (ed.), Individual Forecasting and Aggregate Outcomes: "Rational Expectations" Examined, Cambridge University Press, 1983.

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"Reply to De Long and Summers" in Robert J. Gordon (ed.), The American Business Cycle: Continuity and Change, University of Chicago Press for NBER, 1986.

"Comments on 'How Firm is the Deep Structure of Real Business Cycle Theory' by Michael Parkin," Carnegie-Rochester Conference Series on Public Policy," North-Holland, forthcoming 1988.

"Comment on 'Equilibrium Interpretations of Employment and Real Wages' by John Kennan," in S.Fischer (ed.) Macroeconomics Annual, Vol. 3, 1988.

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RESPONSE TO WRITTEN QUESTIONS OF CHAIRMAN RIEGLE FROM
JOHN MICHAEL FARREN

Q. Mr. Lionel Olmer, who had the job for which you have been nominated for four years in the Reagan Administration, told this Committee in his confirmation hearing in April 1981 that in Japan there is a clear recognition that control of major future world markets will be heavily dependent on supremacy in high technology and had developed a national program to assure its preeminence in knowledge intensive industries.

Mr. Olmer described efforts that the Reagan Administration would make to keep American industry competitive against that challenge from Japan.

I think concerns about America's competitive position are much more intense with good reason than they were in 1981. What does the Bush Administration plan to do to help American companies remain competitive vis a vis their American counterparts? Is this a matter you plan to work on? If so, is this your highest priority?

A. Restoring and enhancing the global competitiveness of American industry is Secretary Mosbacher's highest priority and, if confirmed, it certainly will be mine as well. While I would emphasize that this is a global effort, you are correct in pointing out that in several key areas our programs will have to be Japan-specific. If confirmed by the Senate, I plan to be particularly active in three areas:

-Market access--Administration efforts to open the Japanese market are not related solely to today's trade balance. Japan is not only the second largest world market for high technology products (or in the case of semiconductors, the world's largest), it is also the most relevant world market for cutting edge products. Unless our companies can compete at the full range of their powers in the Japanese market, they cannot be fully competitive in the world market as a whole. In telecommunications for example, our companies must be able to sell their most advanced equipment in Japan, while they enjoy a competitive lead, not only to recoup appropriate

-Access to technology--The U.S. must be as aggressive as our Japanese competitors in both protecting our technology from unfair exploitation and in commercializing promising foreign-origin technology. The clarifications which Commerce sought in the original FSX agreement were aimed not only at preventing the transfer of commercially sensitive technology to potential competitors in Japan, but also at ensuring practical U.S. access to Japanese-developed technologies which might be useful to our companies. Commerce will continue to have a role in future defense-related MOU's. The Department is working with our industry to make sure that they pursue opportunities for access to Japanese technology provided under our 1988 Science and Technology Agreement.

Q. Former Defense Secretary Harold Brown states in an April 21, 1987 speech entitled "Competitiveness and National Security in U.S. Japan Relations" that growing Japanese financial power would likely translate into political and economic power. "Japan," he noted "could retaliate to such U.S. acts as tariffs on products containing semiconductors by reducing the rate of purchase of U.S. government securities".

Have you seen any evidence that the Japanese are using their growing financial power as leverage over us in trade negotiations?

A. I have not seen any indication that the Japanese are using their financial holdings as leverage in trade negotiations, but that potential cannot be dismissed. More than any other nation, Japan benefits from open American markets (merchandise and financial) and from the open world system which we support. The disruption in these systems which would follow on the use of Japanese leverage would be very costly to Japan. Moreover, it is not clear that Japan has alternative investment opportunities which would be as economically and politically attractive.

I am more concerned about the leverage which derives from our dependence on Japan in non-financial areas. In the example that you cite, the dependence of our computer manufacturers on Japanese semiconductors--and indications that some Japanese suppliers might use access to needed chips as leverage--caused serious problems in the implementation of our semiconductor arrangement. The Defense Science Board has drawn attention to the potential problems associated with our dependence on Japan for critical components in major weapons systems.

3. Mr. Thomas Murrin, Chairman of the Defense Department's Defense Manufacturing Board, recently testified before the Senate Armed Services Committee. In his prepared testimony he states that the DOD Industrial Base Committee was going to examine DOD policies related to foreign ownership and control of defense production and suggest appropriate polices and procedures.

Do you have any concerns about foreign ownership of American defense related industries or any other industries? Does the person representing the Commerce Department on the Committee on Investment in the United States (CFIUS) report to you?

A. The United States has traditionally welcomed international investment flows determined by market forces. This policy is based on the belief that an open investment climate promotes U.S. and global growth and development, creates jobs, and adds to our standard of living. This policy was spelled out in some detail in the September 1983 Presidential statement on international investment policy. I agree with that policy.

At the same time, I believe that foreign investment must be consistent with our national security interests. Our open investment policy has always allowed for national security exceptions, and I believe that the recent Exon-Florio provisions of the 1988 trade act have helped ensure that the President has adequate authority to ensure that our national security interests are protected in individual foreign investment transactions.

The Committee on Foreign Investment in the United States (CFIUS) has been delegated authority by the President to implement the Exon-Florio provisions. I believe the CFIUS process is working well. Since passage of the trade act, CFIUS has reviewed more than 60 foreign investment transactions under the Exon-Florio provisions. Many of these cases have been identified and referred to CFIUS by the Commerce Department.

In the recent Executive Order implementing the Trade and Competitiveness Act of 1988, the President elevated to the Cabinet level representation on the Committee on Foreign Investment in the United States. The Secretary of Commerce is now the Department's official representative on CFIUS. (In the past, CFIUS operated at the Assistant Secretary level.) The International Trade Administration provides staff support and coordinates Commerce participation on the Committee. The Assistant Secretary for Trade Development, who reports to the Under Secretary for International Trade, is responsible for this coordination and directs staff support for CFIUS on a day-to-day basis.

STATEMENT FOR COMPLETION BY PRESIDENTIAL NOMINEES

Name: FARREN (LAST) John (J.) (FIRST) Michael (OTHER)

Position to which nominated: Under Secretary of Commerce for International Trade Administration Date of nomination: May 16, 1989

Date of birth: 21 (DAY) Nov. (MONTH) 1952 (YEAR) Place of birth: Waterbury, CT

Marital status: Single Full name of spouse: None

Name and ages of children: None

Education:

Institution	Dates attended	Degrees received	Dates of degrees
Fairfield University Fairfield, CT	9/70-6/74 ~~& 12/76~~	B.A.	1977
Trinity College Hartford, CT	~~8/77-6-82~~	M.P.P.	1982
University of Connecticut Law School	9/79-6/82	J.D.	1982

Honors and awards: List below all scholarships, fellowships, honorary degrees, military medals, honorary society memberships, and any other special recognitions for outstanding service or achievement.

None

Memberships: List below all memberships and offices held in professional, fraternal, business, scholarly, civic, charitable and other organizations.

Organization	Office held (if any)	Dates
American Bar Association	Member	1983 - present
Connecticut Bar Association	Member	1983 - present
D. C. Bar Association	Member	1983 - present
International Bar Association	Member	1983 - present
Fraternal Order of Elks	Member	1974 - present
Waterbury Easter Seals Rehab. Ctr.	Board Member	1977 - 1981
Connecticut Business Coalition to Save Energy	Secretary/ Board Member	1979 - 1981

Employment record: List below all positions held since college, including the title or description of job, name of employment, location of work, and dates of inclusive employment.

Consultant to the Secretary, U.S. Dept of Commerce Washington, DC	1/89 - present
Deputy Director, Office of the President-Elect, Washington, DC	11/88 - 1/89
Counsel, Wiggin & Dana Law Firm New Haven, Connecticut	9/88 - 11/88
Consultant, Republican National Committee Washington, DC	9/88
Deputy Director of Operations/Convention (Volunteer) George Bush for President, Washington, DC	8/88
Consultant to the Under Secretary, International Trade Admin. Department of Commerce, Washington, DC	5/88 - 7/88
Deputy Under Secretary f/International Trade Administration, Department of Commerce, Washington, DC	9/85 - 5/88
Counsellor to the Secretary of Commerce, Office of the Secretary, Washington, DC	3/85 - 9/85
Director of Business Liaison, Office of the Secretary Department of Commerce, Washington, DC	6/83 - 3/85
Director of White House Liaison & Exec. Asst. to the Deputy Chairman, Republican National Cmte, Washington, DC	8/81 - 6/83
Vice President, Greater Waterbury Chamber of Commerce Waterbury, Connecticut	12/78 - 8/81
Deputy Campaign Manager, Sarasin f/Governor Committee No current address	1/78 - 11/78
Vice President, Greater Waterbury Chamber of Commerce Waterbury, Connecticut	9/77 - 1/78
District Representative, Staff of Cong. Ronald A. Sarasin Washington, DC	12/76 - 9/77
Campaign Director, Sarasin f/Congress Committee No current Address	5/76 - 11/76

Employment Record: Continued from Page 2

District Representative, Staff of Congressman Ronald A. Sarasin, Washington, D.C.	12/74-5/76
Campaign Director, Sarasin for Congress Washington, D.C.	3/74-11/74
Campaign Coordinator, Donnarumma for Mayor Committee, Waterbury, CT	8/73-11/73
Local Reporter, New Haven Register Long Wharf, New Haven, CT	3/73-5/73
Laborer, Currier Electric Company Naugatuck, CT	12/72-1/73 5/72-8/72
Salesclerk, Breen's Inc. Naugatuck, CT	11/68-8/71 (Part-time and during school vacations)

Government experience: List any experience in or direct association with Federal, State, or local governments, including any advisory, consultative, honorary or other part-time service or positions.

Naugatuck, CT Republican Town Committee 1973-74
Candidate for Naugatuck Board of Burgess, 1973
~~Naugatuck, CT Board of Finance, 1973-78~~
Connecticut State Police Auxiliary, 1972-78
Connecticut Advisory Committee on Environmental Quality, 1979-81
See employment history for other positions held.

Published writings: List the titles, publishers and dates of books, articles, reports or other published materials you have written.

None

Political affiliations and activities: List all memberships and offices held in and services rendered to all political parties or election committees during the last 10 years.

Volunteer, Reagan-Bush Campaign 1980
Director of White House Liaison, Republican National Committee, 8/81 - 6/83
Volunteer, Bush for President Committee 8/88
Consultant, Republican National Committee 9/88

Political contributions: Itemize all political contributions of $500 or more to any individual, campaign organization, political party, political action committee or similar entity during the last eight years and identify the specific amounts, dates, and names of the recipients.

$1,000 - Rowland for Congress Committee 9/88

Qualifications: State fully your qualifications to serve in the position to which you have been named. (attach sheet)

See Attachment A

Future employment relationships:

1. Indicate whether you will sever all connections with your present employer, business firm, association or organization if you are confirmed by the Senate.

Yes

2. As far as can be foreseen, state whether you have any plans after completing government service to resume employment, affiliation or practice with your previous employer, business firm, association or organization.

No

3. Has anybody made you a commitment to a job after you leave government?

No

4. Do you expect to serve the full term for which you have been appointed?

Yes

Potential conflicts of interest:

1. Describe any financial arrangements or deferred compensation agreements or other continuing dealings with business associates, clients or customers who will be affected by policies which you will influence in the position to which you have been nominated.

None

2. List any investments, obligations, liabilities, or other relationships which might involve potential conflicts of interest with the position to which you have been nominated.

None

3. Describe any business relationship, dealing or financial transaction (other than tax-paying) which you have had during the last 10 years with the Federal Government, whether for yourself, on behalf of a client, or acting as an agent, that might in any way constitute or result in a possible conflict of interest with the position to which you have been nominated.

None

4. List any lobbying activity during the past 10 years in which you have engaged for the purpose of directly or indirectly influencing the passage, defeat or modification of any legislation at the national level of government or affecting the administration and execution of national law or public policy.

As an employee of the Greater Waterbury Chamber of Commerce, I advocated business positions on public policy matters. As Director of White House Liaison for the Republican National Committee I advocated Republican Party and Reagan Administration positions on a number of issues.

5. Explain how you will resolve any potential conflict of interest that may be disclosed by your responses to the above items.

I will consult with the General Counsel of the Department of Commerce and, if appropriate, divest myself of conflicting interests, recuse myself, or obtain a waiver of conflict of interest restrictions under 15 U.S.C.§208(b), if the interest is not substantial.

Civil, criminal and investigatory actions:

1. Give the full details of any civil or criminal proceeding in which you were a defendant or any inquiry or investigation by a Federal, State, or local agency in which you were the subject of the inquiry or investigation.

None

2. Give the full details of any proceeding, inquiry or investigation by any professional association including any bar association in which you were the subject of the proceeding, inquiry or investigation.

None